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Establishing and maintaining a system of quality control for a CPA firm's accounting and auditing practice

American Institute of Certified Public Accountants. Quality Control Standards Task Force

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**AICPA Audit and Accounting
Practice Aid Series**

**Establishing and Maintaining
a System of Quality Control
for a CPA Firm's Accounting
and Auditing Practice**

Revised for the Issuance of Statement on Quality Control
Standards No. 7, *A Firm's System of Quality Control*



Notice to Readers

This AICPA Audit and Accounting Practice Aid updates *Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, which was issued in 2004. This practice aid is intended to help practitioners better understand and apply Statement on Quality Control Standards (SQCS) No. 7 issued by the AICPA. That standard is included in Appendix A of this practice aid. This version of the practice aid, prepared by the Quality Control Standards Task Force, has been revised to incorporate new policies and procedures that a firm should consider including in its system of quality control to be responsive to the issuance of SQCS No. 7. The policies and procedures presented in this practice aid are illustrative, and firms are encouraged to consider them in designing and maintaining a system of quality control that is appropriate for their accounting and auditing practices. Some of the policies and procedures presented in this practice aid are not required by the SQCSs; however, they represent the views of the task force regarding best practices for a quality control system. Although this practice aid has been reviewed by the AICPA Audit and Attest Standards staff, it has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA and has no official or authoritative status.

The Sarbanes-Oxley Act of 2002 (Act) created the Public Company Accounting Oversight Board (PCAOB) and charged it with overseeing audits of issuers,¹ as defined by the Act. Under the Act, the PCAOB's duties include, among other things, establishing auditing, quality control, ethics, independence, and other standards relating to audits of issuers.

This practice aid does not address the quality control requirements of the Act, nor does it address the quality control requirements of PCAOB standards that must be followed by auditors of issuers. Auditors of issuers should follow these other standards and make changes to their firm's quality control systems as necessary. Auditors of nonissuers who are engaged to report on audit engagements in accordance with PCAOB auditing standards also must report on those engagements in accordance with generally accepted auditing standards (GAAS). Auditing Interpretations No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," and No. 18, "Reference to PCAOB Standards in an Audit Report on a Nonissuer" (AICPA, *Professional Standards*, vol. 1, AU sec. 9508.85–.88 and 9508.89–.92, respectively), of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1), provide reporting guidance for audits of nonissuers when the auditor is asked to report in accordance with GAAS and PCAOB auditing standards.

Additional information about the PCAOB and the Act can be obtained at the PCAOB Web site at www.pcaobus.org.

¹ Paragraph 7 of Section 2, "Definitions," of the Sarbanes-Oxley Act of 2002 states, "The term 'issuer' means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c]), the securities of which are registered under section 12 of that Act [15 U.S.C. 78l], or that is required to file reports under section 15(d) [15 U.S.C. 78o(d)], or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 [15 U.S.C. 77a et seq.], and that it has not withdrawn."

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Prepared by
a Task Force of the
American Institute of Certified Public Accountants

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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CHAPTER 1: OVERVIEW OF STATEMENTS ON QUALITY CONTROL STANDARDS

1.01 The objectives of a system of quality control are to provide a CPA firm with reasonable assurance¹ that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances. Statement on Quality Control Standards (SQCS) No. 7, *A Firm's System of Quality Control* (AICPA, *Professional Standards*, vol. 2, QC sec. 10), was issued by the Auditing Standards Board of the AICPA in October 2007 and is effective for a firm's accounting and auditing practice as of January 1, 2009. This standard supersedes all previously issued SQCSs.

1.02 A system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The nature, extent, and formality of a firm's quality control policies and procedures will depend on various factors such as the firm's size; the number and operating characteristics of its offices; the degree of authority allowed to, and the knowledge and experience possessed by, firm personnel; and the nature and complexity of the firm's practice.

COMMUNICATION OF QUALITY CONTROL POLICIES AND PROCEDURES

1.03 The firm should communicate its quality control policies and procedures to its personnel. Most firms will find it appropriate to communicate their policies and procedures in writing and distribute, or make available electronically, them to all professional personnel.

1.04 Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality
- A requirement for each individual to be familiar with and to comply with these policies and procedures

¹ The term *reasonable assurance*, which is defined as a high, but not absolute, level of assurance, is used because absolute assurance cannot be attained. Statement on Quality Control Standards (SQCS) No. 7, *A Firm's System of Quality Control* (AICPA, *Professional Standards*, vol. 2, QC sec. 10), states, "Any system of quality control has inherent limitations that can reduce its effectiveness."

Effective communication also includes procedures for personnel to communicate their views or concerns on quality control matters to the firm's management.

ELEMENTS OF A SYSTEM OF QUALITY CONTROL

1.05 A firm's system of quality control should include policies and procedures that address each of the following elements of quality control identified in SQCS No. 7:

- Leadership responsibilities for quality within the firm (the "tone at the top")
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

1.06 The elements of quality control are interrelated. For example, a firm continually assesses client relationships to comply with relevant ethical requirements, including independence, integrity, and objectivity, and policies and procedures related to the acceptance and continuance of client relationships and specific engagements. Similarly, the human resources element of quality control encompasses criteria related to professional development, hiring, advancement, and assignment of firm personnel to engagements, all of which affect policies and procedures related to engagement performance. In addition, policies and procedures related to the monitoring element of quality control enable a firm to evaluate whether its policies and procedures for each of the other five elements of quality control are suitably designed and effectively applied.

1.07 If a firm merges, acquires, sells, or otherwise changes a portion of its practice, the surviving firm evaluates and, as necessary, revises, implements, and maintains firm-wide quality control policies and procedures that are appropriate for the changed circumstances.

LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM (THE "TONE AT THE TOP")

1.08 The objective of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. The firm should establish and maintain the following policies and procedures to satisfy this objective:

- Require the firm's leadership (managing partner, board of managing partners or CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control.
- Assign management responsibilities so that commercial considerations do not override the quality of the work performed.
- Assign operational responsibility for the firm's quality control system to personnel who have sufficient and appropriate experience and ability to identify and understand quality control issues and to develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.
- Design policies and procedures addressing performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel to demonstrate the firm's overarching commitment to the objectives of the system of quality control.
- Devote sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

RELEVANT ETHICAL REQUIREMENTS

1.09 The objective of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Establishing and maintaining policies such as the following ordinarily would satisfy this objective:

- Require that personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office (GAO), and any other applicable regulators.
- Establish procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.
- Establish procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.
- Require that the firm withdraw from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.

- Require written confirmation, at least annually, of compliance with the firm's policies and procedures on independence from all firm personnel required to be independent by relevant requirements.
- Establish procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of the engagement. This would apply to national firm personnel, foreign firm personnel, and foreign-associated firms.²
- Require the rotation of personnel for audit or attest engagements where regulatory or other authorities require such rotation after a specified period.

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS

1.10 The objective of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, related parties, and those charged with its governance, and the risks associated with providing professional services in the particular circumstances;
- Is competent to perform the engagement and has the capabilities and resources to do so;
- Can comply with legal and ethical requirements; and
- Has reached an understanding with the client regarding the services to be performed.

1.11 This objective ordinarily should be satisfied before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client by establishing and maintaining policies such as the following:

² A foreign-associated firm is a firm domiciled outside of the United States and its territories that is a member of, correspondent with, or similarly associated with an international firm or international association of firms.

- Evaluate factors that have a bearing on management's integrity and consider the risk associated with providing professional services in particular circumstances.³
- Evaluate whether the engagement can be completed with professional competence; undertake only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluate, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.
- Obtain an understanding, preferably in writing, with the client regarding the services to be performed.
- Establish procedures on withdrawal from an engagement or from both the engagement and the client relationship, including procedures for dealing with information that would have caused the firm to decline an engagement if the information had been available earlier.
- Require documentation of how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.

HUMAN RESOURCES

1.12 The objective of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (b) to enable the firm to issue reports that are appropriate in the circumstances. Establishing and maintaining policies such as the following ordinarily would satisfy this objective:

- Recruit and hire personnel of integrity who possess the characteristics that enable them to perform competently.
- Determine capabilities and competencies required for an engagement, especially for the engagement partner, based on the characteristics of the particular client, industry, and kind of service being performed. Specific competencies necessary for an engagement partner are discussed in paragraph 45 of SQCS No. 7.
- Determine the capabilities and competencies possessed by personnel.

³ Such considerations would include the risk of providing professional services to significant clients or to other clients for which the practitioner's objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a member or a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. Examples of factors to consider in determining the significance of a client to an engagement partner, office, or practice unit include (a) the amount of time the partner, office, or practice unit devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner, office, or practice unit is compensated, or (d) the effect that losing the client would have on the partner, office, or practice unit.

- Assign the responsibility for each engagement to an engagement partner.
- Assign personnel based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.
- Have personnel participate in general and industry-specific continuing professional education and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable continuing professional education requirements of the AICPA, state boards of accountancy, and other regulators.
- Select for advancement only those individuals who have the qualifications necessary to fulfill the responsibilities they will be called on to assume.

ENGAGEMENT PERFORMANCE

1.13 The objectives of the engagement performance element of quality control are to provide the firm with reasonable assurance (a) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (b) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed.

1.14 The objectives of the engagement performance element of quality control ordinarily would be satisfied by establishing and maintaining policies such as the following:

- Plan all engagements to meet professional, regulatory, and the firm's requirements.
- Perform work and issue reports and other communications that meet professional, regulatory, and the firm's requirements.
- Require that work performed by other team members be reviewed by qualified engagement team members, which may include the engagement partner, on a timely basis.
- Require the engagement team to complete the assembly of final engagement files on a timely basis.
- Establish procedures to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.
- Require the retention of engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.

- Require that
 - Consultation take place when appropriate (for example, when dealing with complex, unusual, unfamiliar, difficult, or contentious issues);
 - Sufficient and appropriate resources be available to enable appropriate consultation to take place;
 - All the relevant facts known to the engagement team be provided to those consulted;
 - The nature, scope, and conclusions of such consultations be documented; and
 - The conclusions resulting from such consultations be implemented.
- Require that
 - Differences of opinion be dealt with and resolved;
 - Conclusions reached are documented and implemented; and
 - The report not be released until the matter is resolved.
- Require that
 - All engagements be evaluated against the criteria for determining whether an engagement quality control review should be performed;
 - An engagement quality control review be performed for all engagements that meet the criteria; and
 - The review be completed before the report is released.
- Establish procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.
- Establish criteria for the eligibility of engagement quality control reviewers.

MONITORING

1.15 The objective of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports issued by the firm are appropriate in the circumstances

1.16 The objective of the monitoring element of quality control ordinarily would be satisfied by establishing and maintaining policies such as the following:

- Assign responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.
- Assign performance of the monitoring process to competent individuals.
- Require the performance of monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures. Monitoring procedures consist of the following:
 - Review of selected administrative and personnel records pertaining to the quality control elements
 - Review of engagement working papers, reports, and clients' financial statements
 - Discussions with the firm's personnel
 - Summarization of the findings from the monitoring procedures, at least annually, and consideration of the systemic causes of findings that indicate that improvements are needed
 - Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures
 - Communication of the identified findings to appropriate firm management personnel
 - Consideration of findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis
 - Assessment of
 - o The appropriateness of the firm's guidance materials and any practice aids;
 - o New developments in professional standards and regulatory and legal requirements and how they are reflected in the firm's policies and procedures where appropriate;
 - o Compliance with policies and procedures on independence;

- o The effectiveness of continuing professional development, including training;
 - o Decisions related to acceptance and continuance of client relationships and specific engagements; and
 - o Firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof.
- Communicate at least annually, to relevant engagement partners and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.
- Communicate the results of the monitoring of its quality control system process to relevant firm personnel at least annually.
- Establish procedures designed to provide the firm with reasonable assurance that it deals appropriately with the following. This includes establishing clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisal and documenting complaints and allegations and the responses to them:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
 - Allegations of noncompliance with the firm's system of quality control
 - Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations
- Require appropriate documentation to provide evidence of the operation of each element of its system of quality control. The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following, for example:
 - The size of the firm and the number of offices
 - The nature and complexity of the firm's practice and organization
- Require retention of documentation providing evidence of the operation of the system of quality control for a period of time sufficient to permit those performing monitoring procedures and peer review to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

1.17 Some of the monitoring procedures discussed in the previous list may be accomplished through the performance of the following:

- Engagement quality control review
- Post-issuance review of engagement working papers, reports, and clients' financial statements for selected engagements
- Inspection⁴ procedures

DOCUMENTATION OF QUALITY CONTROL POLICIES AND PROCEDURES

1.18 The firm should document each element of its system of quality control. The extent of the documentation will depend on the size, structure, and nature of the firm's practice. Documentation may be as simple as a checklist of the firm's policies and procedures or as extensive as practice manuals.

APPLYING THE QUALITY CONTROL STANDARDS TO FOUR HYPOTHETICAL FIRMS

1.19 Subsequent chapters in this practice aid present four different hypothetical firms and the quality control policies and procedures each firm implements to address each of the quality control elements. Following is a description of those firms and their characteristics:

- Multi-Office CPA Firm has 10 offices in 3 states and is centrally managed. It has approximately 15 partners and 100 professionals. Its accounting and auditing practice has a concentration of financial institution clients for which it performs audit and attest services. Multi-Office CPA Firm has no issuer clients. (Chapter 2)
- Single-Office CPA Firm has 1 office, 3 partners, and 10 professionals. Its accounting and auditing practice has a concentration of employee benefit plan audits. Single-Office CPA Firm has no issuer clients. (Chapter 3)
- Sole Practitioner, CPA, is a sole owner who has no professional staff and occasionally hires per diem professionals. Her accounting practice consists only of engagements subject to Statements on Standards for Accounting and Review Services (SSARs). (Chapter 4) (Note: Sole practitioners who perform audit and attest engagements should refer to Chapter 3.)

⁴ Inspection is a retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Although monitoring procedures are meant to be ongoing, they may include inspection procedures performed at a fixed point in time. Monitoring is a broad concept; inspection is one specific type of monitoring procedure.

- Closely Aligned CPA Firm and Non-CPA-Owned Entity are organized in an *alternative practice structure*, which is a nontraditional structure in the practice of public accounting consisting of an attest and a nonattest portion of the practice. The attest portion is conducted through a firm, Closely Aligned CPA Firm, owned and controlled by CPAs. The nonattest portion is conducted through a separate entity, Non-CPA-owned Entity, owned and controlled by individuals who are not CPAs. (Chapter 5)

1.20 The policies and procedures described in each chapter are those that a firm of a similar size and type may consider establishing and maintaining. The policies and procedures used by an actual firm need not necessarily include nor be limited to all those used by the illustrative firms.

CHAPTER 2: SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S ACCOUNTING AND AUDITING PRACTICE—FIRM WITH MULTIPLE OFFICES

2.01 This chapter describes how a CPA firm that has multiple offices (Multi-Office CPA Firm) implements each element of quality control in its accounting and auditing practice. Multi-Office CPA Firm is a hypothetical firm that has 10 offices in 3 states and is centrally managed. Multi-Office CPA Firm has 15 partners, 100 professionals, and a concentration of financial institution clients for which it performs audit and attest services. The firm uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm's partners. It has no issuer clients.¹

QUALITY CONTROL POLICIES AND PROCEDURES

2.02 The firm's system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The policies and procedures are required to be documented. Multi-Office CPA Firm documents its system of quality control by preparing a document that comprehensively describes policies and procedures established and maintained for each element of quality control. Multi-Office CPA Firm reviews the documentation at least annually and updates it as necessary.

2.03 The firm should communicate its quality control policies and procedures to its personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

2.04 Multi-Office CPA Firm communicates these policies and procedures in writing and makes the documentation available electronically to all professional personnel. Multi-Office CPA Firm requires each individual to be familiar with and to comply with these policies and procedures. Multi-Office CPA Firm also includes procedures for personnel to communicate their views or concerns on quality control matters to partners.

¹ If Multi-Office CPA Firm were to be engaged to perform audit services for an issuer, it might need to revise its quality control policies and procedures to comply with PCAOB (Public Company Accounting Oversight Board) standards and to reflect SEC (Securities and Exchange Commission) requirements applicable to audits of issuers.

LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM (THE “TONE AT THE TOP”)

2.05 The objective of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.06–2.10.

2.06 *Policy 1: The firm's managing partner assumes ultimate responsibility for the firm's system of quality control.* Multi-Office CPA Firm implements this policy through the following procedures:

- Having the managing partner accept overall responsibility for the firm's system of quality control and promoting a quality-oriented culture by sending clear, consistent, and frequent messages through e-mails, letters, and recordings
- Having a mission statement that includes the firm's core values and the importance of quality
- Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action

2.07 *Policy 2: The firm assigns management responsibilities so that commercial considerations do not override the quality of the work performed.* Multi-Office CPA Firm implements this policy through the following procedures:

- Having the managing partner continually evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control
- Emphasizing to all personnel that fee considerations and scope of services should not infringe upon quality work

2.08 *Policy 3: The firm assigns operational responsibility for the firm's quality control system to personnel who have sufficient and appropriate experience and ability to identify and understand quality control issues and to develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.* Multi-Office CPA Firm implements this policy through the following procedures:

- Designating a quality control partner with overall operational responsibility for developing and implementing appropriate policies and procedures for the firm's quality control system
- Designating a quality control individual for each office

2.09 *Policy 4: The firm designs procedures addressing performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel to demonstrate the*

firm's overarching commitment to the objectives of the system of quality control. Multi-Office CPA Firm implements this policy through the following procedures:

- Designing and implementing performance evaluation and advancement systems that (a) reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards and (b) include partner performance peer evaluations.
- Establishing a compensation system that provides incentives to accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system does the following:
 - Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed
 - Rewards partners and personnel for timely (a) identification of significant and emerging accounting and auditing issues and (b) consultation with firm experts

2.10 Policy 5: The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures. Multi-Office CPA Firm implements this policy through the following procedures:

- Providing the designated quality control partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's quality control policies and procedures
- Providing the firm's quality control documentation to personnel when they are initially hired and reviewing the documentation with them
- Reviewing the firm's quality control policies and procedures with personnel at firm training sessions at least annually

RELEVANT ETHICAL REQUIREMENTS

2.11 The objective of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.12–2.18.

2.12 Policy 1: Personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the U.S. Government Accountability Office (GAO), and any other applicable regulators. Multi-Office CPA Firm implements this policy through the following procedures:

- Assigning one of its partners the responsibility of responding to questions, resolving matters, and determining the circumstances for which consultation with sources outside the firm is required for matters related to independence, integrity, and objectivity
- Identifying circumstances for which documentation of the resolution of matters is appropriate
- Maintaining a current list of (a) all entities with which firm personnel are prohibited from having a financial or business relationship and (b) all activities in which the firm is prohibited² from engaging, as defined in the firm's independence policies
- Establishing clear and concise written independence guidance covering relationships and activities that impair independence, including but not limited to investments, loans, brokerage accounts, business relationships, employment relationships, and fee arrangements

2.13 *Policy 2: The firm establishes procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.* Multi-Office CPA Firm implements this policy through the following procedures:

- Having the managing partner (through e-mails, letters, or recordings) emphasize the concepts of independence, integrity, and objectivity in the firm's professional development meetings, in the acceptance and continuance of clients and engagements, and in the performance of engagements. Because Multi-Office CPA Firm has a concentration of financial institution clients, this also includes discussing the applicability of these concepts to engagements for financial institutions, such as the prohibition against any member of the engagement team having a "non-grandfathered" loan with the institution, and the types of nonattest services that could affect independence.
- Requiring periodic independence and ethics training for all professional personnel. Such training covers the firm's independence and ethics policies and the independence and ethics requirements of all applicable regulators.
- Providing frequent reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity.
- Informing personnel on a timely basis of those entities to which independence policies apply by doing the following:
 - Preparing and maintaining a list of entities with which firm personnel are prohibited from having a financial or business relationship
 - Making the list available to personnel so they may evaluate their independence (including personnel new to the firm or an office)
 - Notifying personnel of changes in the list

² Examples of prohibited activities include providing certain valuation and information technology services to an audit client. See the rules of specific standard-setters to determine the extent and relevance of any prohibition.

2.14 *Policy 3: The firm establishes procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.* Multi-Office CPA Firm implements this policy through the following procedures:

- Assigning a partner who is not otherwise associated with the engagement, or who practices in an office other than the office that performs the attest engagement, to review the engagement
- Requiring approval of the assignment of engagement personnel by another partner or manager
- Rotating engagement partners periodically
- Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for (a) significant clients or (b) clients at which partners or other senior personnel are offered key management positions, or accept offers of employment, by utilizing the procedures contained in the AICPA Code of Professional Conduct, ET section 100.01 and 100.04, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2)
- Designating a senior-level partner to be responsible for overseeing the adequate functioning of the firm's independence policies
- Implementing a system to identify investment holdings of partners and managers that might impair independence
- Requiring all professionals to report, on a timely basis when identified, apparent violations of independence, integrity, or objectivity policies involving themselves, their spouses, or their dependents and the corrective actions taken or proposed to be taken
- Establishing a requirement for all professional personnel to notify the managing partner in each office of any potential activities that might impair independence or violate ethics rules, including services provided to entities with which firm personnel are prohibited from having a business relationship
- Establishing a program that protects professional personnel who report potential ethics or independence violations to the proper parties in compliance with firm policy
- Requiring the managing partner in each office, or a person designated by the managing partner, to periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence
- Developing guidance that sets forth the consequences for professional personnel who violate the firm's independence policies and procedures, including engaging in activities with entities with which firm personnel are prohibited from having a business relationship

- Requiring all professional personnel to review the list of entities with which firm personnel are prohibited from having a business relationship before a professional or the spouse or dependent of a professional obtains a security or financial interest in an entity
- Establishing criteria that determine the need for safeguards for engagements where monitoring procedures or peer review have identified weaknesses in previous years or the same senior personnel have been used for five years or more on an audit or attestation engagement
- Documenting any safeguards applied to eliminate threats to independence or reduce them to an acceptable level
- Promptly communicating identified breaches of these policies and procedures, and the required corrective actions, to (a) the engagement partner who, with the firm, needs to address the breach and (b) other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action
- Obtaining confirmation from the engagement partner and other relevant personnel that the required corrective actions have been taken

2.15 *Policy 4: The firm withdraws from engagements if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.* Multi-Office CPA Firm implements this policy through the following procedures:

- Consulting within the firm and, if necessary, with legal counsel and other parties when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied
- Withdrawing from engagements when effective safeguards to reduce threats to independence to an acceptable level cannot be applied

2.16 *Policy 5: The firm obtains written confirmation, at least annually, of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant requirements.* Multi-Office CPA Firm implements this policy through the following procedures:

- Obtaining written representations from personnel, upon hire and on an annual basis, stating that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation (such written representations are accompanied by the most current list of all entities with which firm personnel are prohibited from having a financial or business relationship)

- Assigning responsibility to the firm's quality-control partner for obtaining such written representations, reviewing independence compliance files for completeness, and resolving reported exceptions
- Requiring the engagement partner to sign a step in the engagement program attesting to compliance with independence requirements that apply to the engagement

2.17 Policy 6: The firm establishes procedures for confirming the independence of another firm or firm personnel in associated member firms who perform part of an engagement. Multi-Office CPA Firm implements this policy through the following procedures:

- Describing in its policies and procedures manual the form and content of independence representations, and frequency with which they are to be obtained
- Requiring that such representations be documented

2.18 Policy 7: The firm rotates personnel for audit or attest engagements where regulatory or other authorities require such rotation after a specified period. Multi-Office CPA Firm implements this policy by having the quality control partner monitor regulatory requirements for financial institutions and other entities and notifying partners of the need for rotation. Multi-Office CPA Firm has decided to rotate partners assigned to audit financial institutions every five years.

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS

2.19 The objective of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, related parties, and those charged with its governance, and the risks associated with providing professional services in the particular circumstances;
- Is competent to perform the engagement and has the capabilities and resources to do so;

- Can comply with legal and ethical requirements; and
- Has reached an understanding with the client regarding the services to be performed.

2.20 Multi-Office CPA Firm satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 2.21–2.25.

2.21 *Policy 1: The firm evaluates factors that have a bearing on management's integrity and considers the risk associated with providing professional services in particular circumstances.* Multi-Office CPA Firm implements this policy through the following procedures:

- Developing and maintaining a manual that contains policies and procedures related to the acceptance of prospective clients and the continuance of existing clients. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.
- Advising professional personnel that they are expected to be familiar with the firm's policies and procedures for the acceptance and continuance of clients.
- Obtaining and evaluating relevant information before accepting or continuing any client. The following are examples of such information:
 - The nature and purpose of the services to be provided and management's understanding thereof.
 - The identity of the client's principal owners, key management, related parties, and those charged with its governance.
 - The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to regulators, enforcement actions by regulators, and income tax returns.
 - Information obtained from inquiries of third parties about the client, its principal owners, key management, and those charged with governance that may have a bearing on evaluating the client. Examples of such third parties are bankers, factors, legal counsel, credit services, investment bankers, underwriters, and other members of the financial or business community who may have applicable knowledge. Inquiries also might be made regarding management's attitude toward compliance with regulators or legislative requirements and the presence of control deficiencies, especially those that management is unwilling to correct.
- Communicating with the predecessor accountant or auditor when required or recommended by professional standards. This communication also includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion shopping.

- Assessing management's commitment to implementing and maintaining effective internal control.
- Assessing management's commitment to the appropriate application of generally accepted accounting principles.
- Conducting a background check of the business, its officers, and the person(s) in question by using an investigative firm and evaluating the information obtained regarding management's integrity. Background checks are conducted when the firm is unable to obtain sufficient information about the prospective client after completing the steps listed above, or when there is an indication that management or someone affiliated with the prospective client may be less than reputable.
- Evaluating the risk of providing services to significant clients or to other clients for which the firm's independence or the appearance of independence may be impaired. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner is compensated, and (d) the effect that losing the client would have on the partner and the firm.

2.22 Policy 2: The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued. Multi-Office CPA Firm implements this policy through the following procedures:

- Evaluating whether the following are in place:
 - The practice office has sufficient personnel who have obtained or can reasonably expect to obtain the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.
 - Specialists are available if needed, through, for example, the resources of another practice office or alternative source.
 - The firm is able to complete the engagement within the reporting deadline.
- Defining high-risk engagements.
- Specifying conditions that trigger the requirement between annual audits to reevaluate a client or engagement. The following are examples of such conditions:

- Significant changes in the client, such as a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or its financial stability.
- Changes in the nature or scope of the engagement, such as an initial public offering or a request to step down from an audit to a review engagement.
- Changes in the composition or strategic focus of the firm, such as the inability to replace the loss of key personnel who are particularly knowledgeable about a specialized industry or a decision by Multi-Office CPA firm to discontinue services to clients in a particular industry.
- The existence of conditions that would have caused the firm to reject the engagement had such conditions existed at the time of the initial acceptance, such as aggressive earnings management, unreliable processes for developing accounting estimates, questionable estimates by management, questions regarding the entity's ability to continue as a going concern, and other factors that may increase the risk of being associated with the client.
- The client's delinquency in paying fees. (This may also affect the firm's independence.)
- Engagements for entities operating in highly specialized or regulated industries, such as financial institutions, governmental entities, and employee benefit plans.
- Engagements for entities in the development stage.
- Engagements in which the client has ignored prior recommendations, such as recommendations that address deficiencies in internal control.
- Obtaining relevant information to determine whether the relationship should be continued and establishing the frequency with which client continuance evaluations should be made.
- Evaluating the information obtained regarding acceptance or continuance of a client or engagement through the following activities:
 - The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm, and makes a recommendation about whether the client or engagement should be accepted or continued.
 - The engagement partner completes a client acceptance form and submits it to the managing partner of the practice office for approval.
 - The engagement partner signs a step in the planning program noting that he or she has considered whether the client should be continued, and if conditions exist that trigger the requirement between annual audits to reevaluate a client or engagement, prepares a form documenting his or her rationale and conclusion regarding client continuance.

- The partner responsible for the quality control function assesses and approves the recommendation made by the engagement partner. In certain defined circumstances, such as high-risk engagements, acceptance or continuance decisions also may require approval of the firm's managing partner.
- Establishing procedures for dealing with information that would have caused the firm to decline the engagement if the information had been available earlier.

2.23 *Policy 3: The firm obtains an understanding with the client regarding the services to be performed.* Multi-Office CPA Firm implements this policy by requiring that for all engagements, the firm prepare a written engagement letter documenting the understanding with the client and obtain the client's signature on that letter, thus minimizing the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed.

2.24 *Policy 4: The firm establishes procedures on withdrawal from an engagement or from both the engagement and the client relationship.* Multi-Office CPA Firm implements this policy through the following procedures:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances
- Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place or for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal
- Discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement, or from both the engagement and the client relationship, if the firm determines that it is appropriate to withdraw

2.25 *Policy 5: The firm documents how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.* Multi-Office CPA Firm implements this policy by documenting, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

HUMAN RESOURCES

2.26 The objective of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (b) to enable the firm to issue reports that are appropriate in the circumstances. Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.27–2.33.

2.27 *Policy 1: Personnel who are hired possess the characteristics that enable them to perform competently.* Multi-Office CPA Firm implements this policy by maintaining firm-wide hiring standards and evaluating the firm's personnel needs, including the following:

- Designating a partner or other qualified individual in each office to be responsible for evaluating the overall personnel needs in that practice office and establishing hiring objectives based on factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement
- Developing and maintaining personnel policies and procedures that identify attributes, achievements, and experiences desired in entry-level and experienced personnel
- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation
- Establishing guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions
- Preparing budgets that identify personnel needs at all levels
- Identifying sources of employment candidates such as universities and executive recruiters
- Selecting and training the individuals who will be interviewing candidates or otherwise participating in the hiring process
- Summarizing and evaluating the results of the hiring process for each candidate, including approval by the managing partner, or a person designated by the managing partner, of all hiring decisions

2.28 *Policy 2: The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner.* Multi-Office CPA Firm implements this policy by specifying the competencies that the engagement partner for an accounting, auditing, or attest engagement (or other person responsible for supervising and signing or authorizing

someone to sign the firm's report on such engagements) should possess. Such competencies include having an understanding of the following:

- The role of the firm's system of quality control and the AICPA Code of Professional Conduct, both of which play critical roles in ensuring the integrity of the accounting, auditing, and attest function to users of reports.
- The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through training or participation in similar engagements.
- The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with the engagement and to evaluate the reasonableness of industry-specific estimates.
- The professional standards applicable to the engagement being performed and to the industry in which the client operates. Such standards include accounting, auditing, and attestation standards, as well as rules and regulations issued by applicable regulators.
- The skills that contribute to sound professional judgment, including the ability to exercise professional skepticism.
- How the organization uses information technology and the manner in which information systems are used to record and maintain financial information.

2.29 Policy 3: The firm determines the capabilities and competencies possessed by personnel. Multi-Office CPA Firm implements this policy through the following procedures:

- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation
- Evaluating personnel at least annually to determine their capabilities and competencies

2.30 Policy 4: The firm assigns responsibility for each engagement to an engagement partner. Multi-Office CPA Firm implements this policy through the following procedures:

- Assigning the responsibility for each engagement to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role
- Clearly defining and communicating the responsibilities of the partner to the engagement partner
- Communicating the identity and role of the partner to management and those charged with governance
- Developing and maintaining systems to monitor the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities

2.31 *Policy 5: The firm assigns personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.* Multi-Office CPA Firm implements this policy through the following procedures:

- Designating an appropriate person(s) in each office to be responsible for assigning personnel to engagements based on such factors as the following:
 - Engagement type, size, significance, complexity, and risk profile
 - Specialized experience or expertise required and competencies gained through previous experience or education
 - Need for and availability of staff and supervisors
 - Timing of the work to be performed
 - Continuity and rotation of personnel
 - Opportunities for on-the-job training
 - Situations for which independence or objectivity concerns exist
- Designating a partner to be responsible for partner and manager assignments
- Requiring approval of partner and manager assignments from the industry partner or the quality assurance partner in the case of high-risk or significant client engagements
- Establishing a policy for monitoring the continuation and rotation of engagement partners

2.32 *Policy 6: Personnel participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other applicable regulators.* Multi-Office CPA Firm implements this policy through the following procedures:

- Designating a partner to oversee the development of firm requirements and materials for a professional development program covering subjects relevant to the firm's clients and services. Such responsibilities include the following:
 - Encouraging personnel to pass the Uniform CPA Examination
 - Establishing guidelines for participation by personnel in professional development programs and considering the requirements of the AICPA, state boards of accountancy, and applicable regulators in establishing the firm's CPE requirements
 - Maintaining appropriate documentation evidencing that personnel have met the professional education requirements of the firm, the AICPA, state boards of accountancy, and other applicable regulators

- Providing an orientation program and training for new personnel to inform them of their professional responsibilities and firm policies
- Preparing and providing publications and programs to inform personnel of their responsibilities and opportunities
- Developing in-house staff training programs that focus on general and industry-specific accounting and auditing subjects, including audits of financial institutions
- Communicating and distributing to personnel changes in accounting, auditing, attestation, and quality control standards, as well as independence, integrity, and objectivity requirements and the firm's guidance with respect to those standards and requirements
- Encouraging professional personnel at each level in the firm to participate in external professional development activities such as the following:
 - CPE courses
 - Meetings of professional organizations
 - Serving on professional committees
 - Writing for professional publications
 - Speaking to professional groups

2.33 Policy 7: Personnel selected for advancement have the qualifications necessary to fulfill the responsibilities they will be called on to assume. Multi-Office CPA Firm implements this policy through the following procedures:

- Appointing a director of human resources to identify and communicate, in the firm's policies and procedures manual, the qualifications necessary to accomplish responsibilities at each professional level in the firm. This includes the following:
 - Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.
 - Developing evaluation forms for each professional staff classification, including partners. Such forms include evaluation of performance quality and adherence to ethical principals.
 - Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.
- Assigning responsibility to a partner for making advancement and termination decisions for staff and recommendations to the firm's management committee for manager and partner-level advancement and termination. Such responsibilities include the following:

- Identifying responsibilities and requirements for evaluation at each level and indicating who will prepare these evaluations and when they will be prepared
- Reviewing evaluations on a timely basis with the individual being evaluated
- Advising personnel regarding their progress and career opportunities through the following procedures:
 - Evaluating employees annually and at the end of each assignment exceeding three weeks to provide feedback on performance.
 - Summarizing and reviewing with personnel their performance evaluations, including assessing their progress with the firm, at least annually. Considerations include past performance, future objectives of the firm and the individual, assignment preferences, and career opportunities.
 - Evaluating partners periodically by means of performance reviews, peer evaluations, or self-appraisals, as appropriate, to provide feedback and to determine whether they continue to have the qualifications to accomplish their assigned responsibilities and to assume additional responsibilities.

ENGAGEMENT PERFORMANCE

2.34 The objective of the engagement performance element of quality control is to provide the firm with reasonable assurance (a) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (b) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed. Multi-Office CPA Firm satisfies these objectives by establishing and maintaining the policies and procedures described in paragraphs 2.35–2.45.

2.35 *Policy 1: Planning for engagements meets professional, regulatory, and the firm's requirements.* Multi-Office CPA Firm implements this policy by developing, maintaining, and providing personnel with the firm's policies and procedures manual that delineates the factors the engagement team should consider in the planning process and the extent of documentation of these considerations. Planning considerations may vary depending on the size and complexity of the engagement. Planning generally includes the following activities:

- Assigning responsibility to the engagement partner for planning the engagement and assigning responsibilities to appropriate personnel during the planning phase
- Developing or updating background information about the client
- Considering client significance to the firm
- Requiring, for all initial audit clients designated as high risk by the firm, an independent review of planning considerations by either the engagement quality control reviewer or another partner
- Requiring planning documentation that includes the following:
 - Proposed work programs tailored to the specific engagement
 - Staffing requirements, including the need for personnel with specialized knowledge who may have to be obtained from other practice offices
 - Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement
 - Consideration of risks and how they may affect the procedures to be performed
 - A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality control policies and procedures
 - Evidence of review of planning by an independent review partner

2.36 *Policy 2: The engagement is performed, supervised, reviewed, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.* Multi-Office CPA Firm implements this policy by requiring personnel to comply with the firm's policies and procedures manual, which prescribes the following:

- How engagement teams are supervised during the course of an engagement, including briefing the engagement team on the objectives of their work
- The form and content of documentation of the work performed and conclusions reached, including forms, checklists, and questionnaires to be used in performing engagements
- The form in which instructions are to be given to other offices or other auditors performing part of an engagement and the extent to which such work is to be reviewed and documented
- The extent of overall engagement review required, at all professional levels, to ensure that the financial statements meet professional and firm presentation and disclosure requirements
- The extent of review to be performed of required communications to management and the board of directors

2.37 *Policy 3: Qualified engagement team members review work performed by other team members on a timely basis.* Multi-Office CPA Firm implements this policy through the following procedures:

- Adhering to the following firm guidelines regarding review of documentation of the work performed and conclusions reached, the financial statements, and reports and documentation of the review process:
 - All reviewers are to possess appropriate experience, competence, authority, and responsibility and are to be given access to the firm's reference material and other resources.
 - For each engagement, there is to be appropriate documentation evidencing review of the documentation of the work performed and conclusions reached, the financial statements, and the report.
- Assigning responsibility for the review of all reports, financial statements, and documentation of the work performed and conclusions reached to an appropriate reviewer in accordance with procedures outlined in the firm's manual to obtain reasonable assurance of the following:
 - The nature, timing, and extent of procedures performed are consistent with risk assessments and the approach described in the planning documentation. Exceptions are appropriately investigated. The appropriateness of planned procedures should be reconsidered if significant changes in risk factors occur or are identified between the planning phase of the engagement and the execution of procedures.
 - Firm-prescribed forms, checklists, and questionnaires, tailored as appropriate, are used in performing and reporting on the engagement.
- Requiring a second review, by a partner or manager, of the report, financial statements, and selected documentation of the work performed and conclusions reached, as prescribed in the firm's policies and procedures manual. The extent of review varies based on the type of engagement. For example, engagements for financial institutions, high-risk engagements, and those performed for significant clients, as defined by the firm, receive an engagement quality control review.
- Reviewing engagement documentation to determine whether the following has occurred:
 - The work has been performed in accordance with professional standards and regulatory and legal requirements.
 - Significant findings and issues have been raised for further consideration.
 - Appropriate consultations have taken place, and the resulting conclusions have been documented and implemented.

- The nature, timing, and extent of work performed are appropriate and do not need revision.
- The work performed supports the conclusions reached and is appropriately documented.
- The evidence obtained is sufficient and appropriate to support the report.
- The objectives of the engagement procedures have been achieved.

2.38 *Policy 4: Engagement teams complete the assembly of final engagement files on a timely basis.* Multi-Office CPA Firm implements this policy by completing the assembly of final engagement files in accordance with professional standards and applicable regulatory requirements, if any.

2.39 *Policy 5: The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.* Multi-Office CPA Firm implements this policy through the following procedures:

- Establishing and applying controls to accomplish the following:
 - Clearly determine when and by whom engagement documentation was prepared and reviewed.
 - Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.
 - Prevent unauthorized changes to the engagement documentation.
 - Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.
- Requiring the use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
- Implementing appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Implementing procedures for properly distributing engagement documentation materials to the team members at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement
- Implementing procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation
- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:

- Generate scanned copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
- Integrate the scanned copies into the engagement files, including indexing and signing off on the copies as necessary.
- Enable the scanned copies to be retrieved and printed as necessary.

2.40 *Policy 6: The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.* Multi-Office CPA Firm implements this policy through the following procedures:

- Establishing procedures that accomplish the following:
 - Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.
 - Provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
 - Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.
- Retaining documentation for a specific period of time as appropriate for the nature of the engagement

2.41 *Policy 7: The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions resulting from such consultations are implemented.* Multi-Office CPA Firm implements this policy through the following procedures:

- Providing personnel with the firm's policies and procedures manual that specifies the firm's consultation policies and procedures. Areas or specialized situations for which the firm requires consultation include the following:
 - Application of newly issued technical pronouncements.
 - Industries with special accounting, auditing, or reporting requirements.
 - Emerging practice problems.
 - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made.

- Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the date a report was issued.
 - Filing requirements of regulators.
 - Meetings with regulators at which the firm is to be called upon to support the application of generally accepted accounting principles or generally accepted auditing standards that have been questioned.
 - Designating individuals within the firm as consultants in certain areas. Personnel are to consult with the designated individual when issues arise. If differences arise between the engagement partner and the consultant, the matter is to be resolved by the partner(s) responsible for the quality control function.
- Maintaining or providing access to adequate and up-to-date references, which includes materials related to specific industries, specialties, and regulatory requirements, in each office.
 - Requiring that documentation of consultation include all relevant facts and circumstances, the sections of the professional literature used in making a determination, the conclusion reached, how the conclusions were implemented, and the signatures of the engagement partner and consultant. This documentation is to be retained with the engagement documentation of the work performed and conclusions reached. At the discretion of the consultant, the documentation may be entered in a retrievable database to promote efficiencies in the consultation process and consistency in the resolution of similar issues.

2.42 *Policy 8: The firm deals with and resolves differences of opinion, documents and implements conclusions reached, and does not release the report until the matter is resolved.* Multi-Office CPA Firm implements this policy through the following procedures:

- Requiring that all differences of professional judgment within an engagement team be resolved by the engagement and quality control partners, and the managing partner if necessary, and that the report not be released until the matter is resolved.
- Requiring that the resolution of the differences be appropriately documented. If members of the engagement team continue to disagree with the resolution, they may disassociate themselves from the resolution of the matter and may document that a disagreement continues to exist.

2.43 *Policy 9: The firm has criteria for determining whether an engagement quality control review should be performed; evaluates all engagements against the criteria; performs an engagement quality control review for all engagements that meet the criteria; and completes the review before the report is released.* Multi-Office CPA Firm implements this policy by defining high-risk engagements and requiring that an engagement quality control review be performed for all

high-risk engagements, engagements for financial institutions, and engagements performed for significant clients.

2.44 Policy 10: The firm establishes procedures addressing the nature, timing, extent, and documentation of the engagement quality control review. Multi-Office CPA Firm implements this policy through the following procedures:

- Implementing procedures addressing the timing of the review. The firm has concluded that performing an engagement quality control review is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the engagement quality control review does not need to be completed before the date of the auditor's report but is required to be completed before the report is released. When the engagement quality control review results in additional audit procedures being performed, the date of the auditor's report is changed to the date by which sufficient appropriate audit evidence has been obtained.
- Implementing procedures addressing the nature and extent of the review. The firm's procedures for audit and attestation engagements require that the engagement quality control reviewer do the following:
 - Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.
 - Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions, and account balances.
 - Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.
 - Review documentation of the resolution of significant accounting, auditing, and financial reporting issues, including documentation of consultation with firm personnel or external sources.
 - Review the summary of uncorrected misstatements that are related to known and likely misstatements.
 - Review additional engagement documentation to the extent considered necessary.
 - Read the financial statements and report and consider whether the report is appropriate.
 - Confirm with the engagement partner that there are no significant unresolved issues.
 - Complete the review before the release of the report.
 - Determine whether the issues raised in the review indicate a need to change the auditor's report date.

- Resolving conflicting opinions between the engagement partner and the engagement quality control reviewer regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report.
- Implementing procedures addressing documentation by the engagement quality control reviewer. The firm's procedures require documentation of the following:
 - That the procedures required by the firm's policies on engagement quality control review have been performed
 - That the engagement quality control review has been completed before the report is released
 - That no matters have come to the attention of the engagement quality control reviewer that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate

2.45 Policy 11: The firm establishes criteria for the eligibility of engagement quality control reviewers. Multi-Office CPA Firm implements this policy by establishing the following criteria for an engagement quality control reviewer:

- Is not selected by the engagement partner
- Has sufficient technical expertise and experience
- Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the engagement partner and the engagement quality control reviewer
- Does not assume any of the responsibilities of the engagement partner or have responsibility for the audit of any significant subsidiaries, divisions, benefit plans, or affiliated or related entities
- Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team
- Does not make decisions for the engagement team or participate in the performance of the engagement, except that the engagement partner may consult the engagement quality control reviewer at any stage during the engagement

MONITORING

2.46 The objective of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied

with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

2.47 Multi-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 2.48–2.51.

2.48 *Policy 1: The firm assigns responsibility for the monitoring process to a partner and assigns performance of the monitoring process to competent individuals.* Multi-Office CPA Firm implements this policy through the following procedures:

- Designating a partner with appropriate authority to be responsible for quality assurance, including ensuring that the firm's quality control policies and procedures and its methodologies remain relevant and adequate. Factors to be considered include the following:
 - Mergers and divestitures of portions of the practice
 - Changes in professional standards and other regulatory requirements applicable to the firm's practice
 - Results of inspections and peer reviews
 - Reviews of litigation and regulatory enforcement actions against the firm and others
 - Changes in applicable AICPA membership requirements
- Preparing inspection checklists and guidance materials or using materials prepared by the AICPA for performing inspection procedures.
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- Identifying the need to take the following actions:
 - Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
 - Improve compliance with firm policies and procedures related to the other elements of quality control.

- Assigning performance of the monitoring process to the designated quality control individual for each practice office.

2.49 *Policy 2: The firm performs monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.* Multi-Office CPA Firm implements this policy through the following procedures:

- Developing and performing the firm's inspection program to obtain feedback about the effectiveness of the firm's policies and procedures.
- Reviewing the resolution of matters reported by professional personnel on independence-confirmation forms to determine that matters have been appropriately considered and resolved.
- Interviewing personnel at all professional management and staff levels to obtain information about operating procedures in practice offices, whether personnel are knowledgeable about firm policies and procedures, and whether such policies and procedures are being effectively communicated.
- Reviewing the following documentation to determine compliance with firm policies and procedures:
 - Personnel evaluations, including documentation of hiring and advancement decisions
 - Documentation of client acceptance and continuance decisions
 - Participants' evaluations of practice office training programs
 - Professional development records of personnel
 - Correspondence regarding the resolution of independence matters within the practice office
- Developing a plan to test a sample of engagements for compliance with the firm's policies and procedures. Such a review may be preissuance or postissuance.
- Reviewing a cross-section of engagements from selected practice offices using the following criteria for inclusion in the sample selected:
 - Engagements involving all partners and managers who have significant accounting and auditing responsibilities in the selected offices
 - Engagements for financial institutions
 - First-year engagements
 - Significant client engagements
 - Specialized industries, with emphasis given to high-risk industries

- Level of service performed (audit, review, compilation, and attestation)
- Level of attestation services performed (examination, review, and agreed-upon procedures)
- Engagements for which there have been complaints or allegations that the work performed by the firm fails to comply with professional standards, regulatory requirements, or the firm's system of quality control
- Engagements in which there were significant disagreements between the quality review partner and the engagement partner
- Periodically reviewing the process for personnel evaluation and counseling to ascertain the following:
 - Procedures for evaluation and documentation are being followed on a timely basis.
 - Personnel who have been promoted have achieved the applicable requirements for advancement.
 - Personnel decisions are consistent with evaluations.
 - Recognition is given to outstanding performance.
- Designating a partner or qualified individual in each office to review the summary of the evaluations of in-house training programs to determine whether the programs are achieving their objectives.
- Designating a partner or qualified individual in each office to review summaries of CPE records for that office's professional staff to determine that the office has established a means of tracking each individual's compliance with the requirements of the AICPA and other applicable regulators.
- Interviewing selected professional personnel regarding the effectiveness of training programs.
- Considering the results of the firm's inspection as they relate to the effectiveness of the firm's professional development program.
- Ascertaining whether inquiries received by individuals consulted within the firm indicate the need for additional CPE programs.
- Reviewing and updating firm practice aids, such as audit programs, forms, and checklists, to reflect new or revised professional pronouncements.
- Issuing guidance regarding new professional standards, regulatory requirements, and related changes to firm policy.
- Soliciting comments from partners and managers as to the effectiveness of practice aids and tools.

2.50 *Policy 3: The firm communicates at least annually (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other appropriate personnel and (b) the results of the monitoring of its quality control system process to relevant firm personnel.* Multi-Office CPA Firm implements this policy through the following procedures:

- Preparing a summary monitoring report for the firm's senior management that evaluates the overall results of the inspection and other monitoring procedures and reaches final conclusions as to whether the firm as a whole needs to improve compliance with the firm's policies and procedures and whether revisions to the firm's quality control policies and procedures are necessary.
- Communicating findings to practice office personnel and determining the corrective actions to be taken for the engagements reviewed. These findings are discussed and communicated in a report issued to each office. The practice office responds regarding the specific corrective actions or steps to be taken to improve compliance with the firm's policies and procedures and professional standards.
- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).
- Communicating in partner-manager meetings and firm policy correspondence the need for changes in the system of quality control.
- Communicating in training programs, partner-manager meetings, and firm policy correspondence the need for improved compliance with the system of quality control.

2.51 *Policy 4: The firm deals appropriately with complaints and allegations.* Multi-Office CPA Firm implements this policy through the following procedures:

- Establishing procedures for concerns to be brought to the attention of the ethics committee in a confidential manner
- Having the firm's ethics committee (excluding any members who are otherwise involved in the engagement under investigation) investigate the following:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
 - Allegations of noncompliance with the firm's system of quality control
 - Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations

- Consulting with legal counsel as necessary
- Documenting complaints and allegations and the responses to them

2.52 Policy 5: The firm prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control. Multi-Office CPA Firm implements this policy by designing its summary monitoring report to provide evidence of the operation of each element of its system of quality control, including the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
 - Adherence to professional standards and regulatory and legal requirements
 - Whether the quality control system has been appropriately designed and effectively implemented
 - Whether the firm's quality control policies and procedures have been appropriately applied
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be

2.53 Policy 6: The firm retains documentation providing evidence of the operation of the system of quality control for an appropriate period of time. Multi-Office CPA Firm implements this policy by requiring retention of the summary monitoring report for a period of time sufficient to meet the firm's peer review or other regulatory requirements.

CHAPTER 3: SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S ACCOUNTING AND AUDITING PRACTICE—FIRM WITH A SINGLE OFFICE

3.01 This chapter describes how a CPA firm that has a single office (Single-Office CPA Firm) implements each element of quality control in its accounting and auditing practice. Single-Office CPA Firm is a hypothetical firm with 1 office, 3 partners, and a total of 10 professionals. Its accounting and auditing practice has a concentration of employee benefit plans, and the firm has no issuer clients.¹ The firm uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. These practice aids are supplemented by oral and written communications from the firm's partners.

QUALITY CONTROL POLICIES AND PROCEDURES

3.02 The firm's system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The policies and procedures are required to be documented. Single-Office CPA Firm documents its system of quality control by preparing a document that comprehensively describes the policies and procedures for each element of quality control. Single-Office CPA Firm reviews the documentation at least annually and updates it as necessary.

3.03 The firm should communicate its quality control policies and procedures to its personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

3.04 Single-Office CPA Firm communicates these policies and procedures in writing and makes the documentation available electronically to all professional personnel. Single-Office CPA Firm requires each individual to be familiar with and to comply with these policies and procedures. Single-Office CPA Firm encourages its personnel to communicate their views or concerns about quality control matters to partners.

¹ If Single-Office CPA Firm were to be engaged to perform audit services for an issuer, it might need to revise its quality control policies and procedures to comply with PCAOB (Public Company Accounting Oversight Board) standards and to reflect SEC (Securities and Exchange Commission) requirements applicable to audits of issuers.

LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM (THE “TONE AT THE TOP”)

3.05 The objective of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.06–3.10.

3.06 *Policy 1: The firm's managing partner assumes ultimate responsibility for the firm's system of quality control.* Single-Office CPA Firm implements this policy through the following procedures:

- Having the managing partner accept ultimate responsibility for the firm's system of quality control and for setting a tone that emphasizes the importance of quality and of following the firm's system of quality control
- Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action

3.07 *Policy 2: Commercial considerations do not override the quality of the work performed.* Single-Office CPA Firm implements this policy through the following procedures:

- Having the managing partner continually evaluate client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control
- Emphasizing to all personnel that fee considerations and scope of services should not infringe upon quality work

3.08 *Policy 3: Responsibility for developing, implementing, and operating the firm's quality control system is assigned to personnel with sufficient and appropriate experience, authority, and ability.* Single-Office CPA Firm implements this policy by having the managing partner designate a quality control partner who is responsible for designing, implementing, and monitoring the firm's quality control system.

3.09 *Policy 4: Performance evaluation, compensation, and advancement (including incentive systems) with regard to personnel demonstrate the firm's overarching commitment to the objectives of the system of quality control.* Single-Office CPA Firm implements this policy through the following procedures:

- Designing and implementing performance evaluation and advancement systems that reward partners and staff involved in the accounting and auditing practice for the quality of their work and their compliance with professional standards.

- Establishing a compensation system that provides incentives to accounting and auditing partners and senior-level employees for the quality of their accounting and auditing work. The compensation system does the following:
 - Takes into consideration firm feedback based on monitoring results and peer reviews of the work performed
 - Rewards partners and personnel for timely (a) identification of significant and emerging accounting and auditing issues and (b) consultation with firm experts

3.10 *Policy 5: The firm devotes sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.* Single-Office CPA Firm implements this policy through the following procedures:

- Providing the designated quality control partner with sufficient time, authority, and resources to develop, implement, and maintain the firm's quality control policies and procedures
- Providing the firm's quality control documentation to personnel when they are initially hired and reviewing the documentation with them
- Reviewing the firm's quality control policies and procedures with personnel at firm training sessions at least annually

RELEVANT ETHICAL REQUIREMENTS

3.11 The objective of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.12–3.17.

3.12 *Policy 1: Personnel adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the GAO (U.S. Government Accountability Office), and any other applicable regulators.* Single-Office CPA Firm implements this policy through the following procedures:

- Designating a quality assurance partner to review relevant pronouncements relating to independence, integrity, and objectivity; answer questions; determine the circumstances for which consultation with sources outside the firm is required; and resolve matters
- Providing personnel with access to the AICPA *Professional Standards* service

- Establishing a system for identifying all services performed for each client and evaluating whether any of those services might impair independence

3.13 *Policy 2: The firm establishes procedures to communicate independence requirements to firm personnel and, where applicable, others subject to them.* Single-Office CPA Firm implements this policy through the following procedures:

- Informing personnel of those entities to which independence policies apply by doing the following on a timely basis:
 - Preparing and maintaining a list of entities with which firm personnel are prohibited from having a financial or business relationship
 - Making the list available to personnel so they may evaluate their independence (including personnel new to the firm)
 - Notifying personnel of changes in the list
- Providing frequent reminders of professional responsibilities to personnel, such as avoiding behavior that might be perceived as impairing their independence or objectivity

3.14 *Policy 3: The firm establishes procedures to identify and evaluate possible threats to independence and objectivity, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards.* Single-Office CPA Firm implements this policy through the following procedures:

- Requiring the engagement partner to consider relevant information about client engagements, including the scope of services, to enable him or her to evaluate the overall impact, if any, on independence requirements
- Accumulating and communicating relevant information to appropriate personnel so that the following can occur:
 - The firm, the engagement partner, and other firm personnel can readily determine whether they satisfy independence requirements.
 - The firm can maintain and update information relating to independence.
 - The firm and the engagement partner can take appropriate action regarding identified threats to independence.
- Requiring personnel to promptly report circumstances and relationships that create a threat to independence, and independence breaches of which they become aware, so that appropriate action can be taken

- Establishing criteria to determine the need for safeguards for engagements where the following have taken place:
 - Monitoring procedures or peer review has identified weaknesses in previous years.
 - The same senior personnel have been used for five years or more on an audit or attestation engagement.
- Promptly communicating identified breaches of these policies and procedures, and the required corrective actions, to the following personnel:
 - The engagement partner who, with the firm, needs to address the breach
 - Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action
- Requiring the engagement partner and the other individuals referred to in the previous list to confirm to the firm that the required corrective actions have been taken
- Having a partner, or an individual designated by the partner, periodically review unpaid fees from clients to ascertain whether any outstanding amounts impair the firm's independence
- Establishing additional procedures that provide safeguards when the firm performs audit or other attest work for (a) significant clients or (b) clients at which partners or other senior personnel are offered key management positions or have accepted offers of employment

3.15 *Policy 4: The firm withdraws from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.* Single-Office CPA Firm implements this policy through the following procedures:

- Consulting within the firm, and with legal counsel and other parties if necessary, when the firm believes that effective safeguards to reduce threats to independence to an acceptable level cannot be applied
- Withdrawing from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied

3.16 *Policy 5: The firm obtains written confirmation, at least annually, of compliance with its policies and procedures on independence from all firm personnel required to be independent by relevant requirements.* Single-Office CPA Firm implements this policy through the following procedures:

- Obtaining written representations from personnel, upon hire and on an annual basis, stating that they have read the firm's independence, integrity, and objectivity policies, understand the applicability of those policies to their activities, and have complied with the requirements of those policies since their last representation. (Such written representations are accompanied by

the most current list of all entities with which firm personnel are prohibited from having a business relationship.)

- Reviewing these independence representations for completeness and resolving reported exceptions.
- Requiring the engagement partner to sign a step in the engagement program attesting to compliance with independence requirements that apply to the engagement.

3.17 *Policy 6: The firm establishes procedures for confirming the independence of another firm that performs part of the engagement.* Single-Office CPA Firm implements this policy through the following procedures:

- Using practice aids that prescribe the form and content of independence representations, and frequency with which they are to be obtained
- Requiring that such representations be documented

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS

3.18 The objective of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, related parties, and those charged with its governance, and the risks associated with providing professional services in the particular circumstances;
- Is competent to perform the engagement and has the capabilities and resources to do so;
- Can comply with legal and ethical requirements; and
- Has reached an understanding with the client regarding the services to be performed.

3.19 Single-Office CPA Firm satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 3.20–3.24.

3.20 *Policy 1: The firm evaluates factors that have a bearing on management's integrity and considers the risk associated with providing professional services in particular circumstances.* Single-Office CPA Firm implements this policy through the following procedures:

- Informing personnel of the firm's policies and procedures for accepting and continuing clients, including those outlined in the firm's practice aids.
- Obtaining and evaluating relevant information such as the following before accepting or continuing a client:
 - The nature and purpose of the services to be provided and management's understanding thereof
 - The identity of the client's principal owners, key management, related parties, and those charged with its governance
 - Information obtained from inquiries of the client's bankers, factors, attorneys, credit services, and others who have business relationships with the entity
 - The nature of the client's operations, including its business practices, from sources such as annual reports, interim financial statements, reports to and from regulators, income tax returns, and credit reports
 - Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control over financial reporting
- Evaluating the risk of providing services for the following engagements:
 - Engagements for entities operating in highly specialized or regulated industries, including financial institutions, governmental entities, and employee benefit plans
 - Engagements that require an inordinate amount of time to complete relative to the available resources of the firm
- Communicating with the predecessor accountant or auditor when required or recommended by professional standards. This communication also includes inquiries regarding the nature of any disagreements and whether there is evidence of opinion-shopping.
- Conducting a background check of the business, its officers, and the person(s) in question by using the services of an investigative company and evaluating the information obtained regarding management's integrity. Background checks are conducted when the firm is unable to obtain sufficient information about the prospective client after taking the steps described above,

or there is an indication that management or someone affiliated with the prospective client may be less than reputable.

- Evaluating the risk of providing services to significant clients or to other clients for which the firm's objectivity or the appearance of independence may be impaired. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement, (b) the effect on the partner's stature within the firm as a result of his or her service to the client, (c) the manner in which the partner is compensated, and (d) the effect that losing the client would have on the partner and the firm.

3.21 *Policy 2: The firm evaluates whether the engagement can be completed with professional competence; undertakes only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluates, at the end of specific periods or upon occurrence of certain events, whether the relationship should be continued.* Single-Office CPA Firm implements this policy through the following procedures:

- Evaluating whether the firm has obtained or can reasonably expect to obtain the knowledge and expertise necessary to perform the engagement, including relevant regulatory or reporting requirements.
- Evaluating whether the following are in place:
 - The firm has sufficient personnel with the necessary capabilities and competence.
 - Specialists are available if needed.
 - Individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when needed.
 - The firm is able to complete the engagement within the reporting deadline.
- Specifying conditions that trigger the requirement to reevaluate a specific client or engagement. The following are examples of such conditions:
 - Significant changes in the client, such as a major change in senior client personnel, ownership, advisers, the nature of its business, or the financial stability of the client.
 - Changes in the nature or scope of the engagement, including requests for additional services.
 - Changes in the composition of the firm, such as the loss of and inability to replace key personnel who are particularly knowledgeable about a specialized industry.
 - The decision to discontinue services to clients in a particular industry.

- The existence of conditions that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance.
 - The client's delinquency in paying fees. (This may also affect the firm's independence.)
 - Engagements for entities operating in highly specialized or regulated industries, such as financial institutions, governmental entities, and employee benefit plans.
 - Engagements for entities in which there may be substantial doubt about the entity's ability to continue as a going concern.
 - Engagements in which the client has ignored prior recommendations, such as those that address deficiencies in internal control.
- Obtaining relevant information to determine whether the relationship should be continued and establishing a frequency for evaluations (for example, continuance decisions are made at least annually).
 - Evaluating the information obtained regarding acceptance or continuance of the client or engagement through the following activities:
 - a. The engagement partner assesses the information obtained about the client or the specific engagement, including information about the significance of the client to the firm, and makes a recommendation about whether the client or engagement should be accepted or continued.
 - b. The engagement partner completes a client acceptance form and submits it to the managing partner for approval.
 - c. The engagement partner signs a step in the planning program noting consideration of client continuance and completes a form documenting the rationale and conclusion regarding client continuance if conditions exist that trigger the requirement to reevaluate a client or engagement between annual audits.
 - d. The managing partner assesses and approves the recommendation made by the engagement partner. If the managing partner recommends not accepting a client or discontinuing a client relationship, the managing partner discusses his or her reasons for the acceptance or continuance decision with the other partners.
 - Establishing procedures for dealing with information that would have caused the firm to decline the engagement if the information had been available earlier.

3.22 Policy 3: The firm obtains an understanding with the client regarding the services to be performed. Single-Office CPA Firm implements this policy by requiring that, for all engagements, the firm prepare a written engagement letter documenting the understanding with the

client and obtain the client's signature on that letter, thus minimizing the risk of misunderstanding regarding the nature, scope, and limitations of the services to be performed.

3.23 Policy 4: The firm establishes procedures on withdrawal from an engagement or from both the engagement and the client relationship. Single-Office CPA Firm implements this policy through the following procedures:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances
- Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place or for the firm to report to regulatory authorities the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal
- Discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship if the firm determines that it is appropriate to withdraw

3.24 Policy 5: The firm documents how issues relating to acceptance or continuance of client relationships and specific engagements were resolved. Single-Office CPA Firm implements this policy by documenting, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

HUMAN RESOURCES

3.25 The objective of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (b) to enable the firm to issue reports that are appropriate in the circumstances. Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.26–3.32.

3.26 Policy 1: Personnel who are hired possess the characteristics that enable them to perform competently. Single-Office CPA Firm implements this policy through the following procedures:

- Designating an individual in the firm to be responsible for the following activities:
 - Managing the human resources function

- Evaluating the firm's personnel needs by considering factors such as existing clientele, anticipated growth, personnel turnover, and individual advancement
- Developing criteria for determining which individuals will be involved in the interviewing and hiring process
- Establishing an understanding among the partners about the attributes, achievements, and experiences desired in entry-level and experienced personnel
- Setting guidelines for the additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions

3.27 Policy 2: The firm determines capabilities and competencies required for an engagement, including those required of the engagement partner. Single-Office CPA Firm implements this policy by specifying the competencies that the engagement partners of the firm's accounting, auditing, and attestation engagements (or other persons responsible for supervising and signing or authorizing someone to sign the firm's report on such engagements) should possess. These competencies include having an understanding of the following:

- The role of the firm's system of quality control and the AICPA Code of Professional Conduct in ensuring the integrity of the accounting, auditing, and attest functions to users of reports.
- The performance, supervision, and reporting aspects of the engagement, which ordinarily are gained through training or participation in similar engagements.
- The industry in which the client operates, including its organization and operating characteristics, sufficient to identify areas of high or unusual risk associated with the engagement and to evaluate the reasonableness of industry-specific estimates.
- The professional standards applicable to the engagement and the industry in which the client operates. Such standards include accounting, auditing, and attestation standards, as well as rules and regulations issued by applicable regulators.
- The skills that contribute to sound professional judgment, including the ability to exercise professional skepticism.
- How the organization uses information technology and the manner in which information systems are used to record and maintain financial information.

3.28 Policy 3: The firm determines the capabilities and competencies possessed by personnel. Single-Office CPA Firm implements this policy through the following procedures:

- Establishing criteria for evaluating personal characteristics such as integrity, competence, and motivation

- Evaluating personnel at least annually to determine their capabilities and competencies

3.29 *Policy 4: The firm assigns the responsibility for each engagement to an engagement partner.* Single-Office CPA Firm implements this policy through the following procedures:

- Assigning responsibility for each engagement to an engagement partner who has the appropriate capabilities, competence, authority, and time to perform the role
- Clearly defining and communicating the responsibilities of the partner to the engagement partner
- Communicating the identity and role of the partner to management and those charged with governance
- Monitoring the workload and availability of engagement partners to enable these individuals to have sufficient time to adequately discharge their responsibilities

3.30 *Policy 5: The firm assigns personnel (including partners) based on the knowledge, skills, and abilities required in the circumstances and the nature and extent of supervision needed.* Single-Office CPA Firm implements this policy through the following procedures:

- Designating an appropriate person to be responsible for assigning personnel to engagements based on such factors as the following:
 - Engagement type, size, significance, complexity, and risk profile
 - Specialized experience and expertise required for the engagement and competencies gained through prior experience
 - Personnel availability
 - Timing of the work to be performed
 - Continuity and rotation of personnel
 - Opportunities for on-the-job training
 - Situations for which independence or objectivity concerns exist
- Designating a partner to be responsible for partner and manager assignments
- Requiring approval of partner and manager assignments from the managing partner or other partner in the case of high-risk or significant client engagements

3.31 *Policy 6: Personnel participate in general and industry-specific continuing professional education (CPE) and professional development activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA*

societies, state boards of accountancy, and other regulators. Single-Office CPA Firm implements this policy through the following procedures:

- Encouraging personnel to pass the Uniform CPA Examination
- Assigning responsibility to a partner to maintain a professional development program that does the following:
 - Requires personnel to participate in professional development programs in accordance with firm guidelines and in subjects that are relevant to their responsibilities
 - Takes into account the requirements of the AICPA, state boards of accountancy, and other regulatory agencies in establishing the firm's CPE requirements
 - Provides CPE course materials to, and maintains records of completed CPE for, professional personnel
 - Provides an orientation and training program for new hires
- Encouraging participation by personnel at each level in the firm in other professional development activities such as completing external professional development programs, including graduate-level and self-study courses, becoming members of professional organizations, serving on professional committees, writing for professional publications, and speaking to professional groups
- Communicating and distributing to personnel, when applicable, changes in accounting, auditing, attestation, and quality control standards, as well as independence requirements and the firm's guidance with respect to those standards and requirements

3.32 Policy 7: Personnel selected for advancement have the qualifications to fulfill the responsibilities they will be called on to assume. Single-Office CPA Firm implements this policy through the following procedures:

- Assigning responsibility to the three partners to jointly make advancement and termination decisions. Such responsibilities include the following:
 - Establishing criteria for evaluating personnel at each professional level and for advancement to the next higher level of responsibility. Such criteria give recognition and reward to the development and maintenance of competence and commitment to ethical principles.
 - Informing firm personnel about the criteria for advancement to the next higher level of responsibility.
 - Designating personnel responsible for preparing evaluations and determining when they should be prepared.

- Informing personnel that failure to adhere to the firm's policies and procedures regarding performance quality and commitment to ethical principles may result in disciplinary action.
- Using forms that include the applicable qualifications when evaluating the performance of personnel. Such forms include qualifications related to performance quality and adherence to ethical principles.
- Reviewing evaluations on a timely basis with the individual being evaluated.
- Counseling personnel regarding their progress and career opportunities by doing the following:
 - Evaluating employees annually and at the end of each assignment lasting four weeks or longer to provide feedback on performance.
 - Summarizing and reviewing with personnel annually the evaluation of their performance, including an assessment of their progress with the firm. Considerations include past performance, future objectives of the individual and the firm, the individual's assignment preferences, and career opportunities.
 - Evaluating partners periodically by means of counseling, peer evaluation, or self-appraisal, as appropriate.

ENGAGEMENT PERFORMANCE

3.33 The objective of the engagement performance element of quality control is to provide the firm with reasonable assurance (a) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (b) that the firm or the engagement partner issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed. Single-Office CPA Firm satisfies these objectives by establishing and maintaining the policies and procedures described in paragraphs 3.34–3.44.

3.34 *Policy 1: Planning for engagements meets professional, regulatory, and the firm's requirements.* Single-Office CPA Firm implements this policy by maintaining and providing personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations. Planning considerations may vary depending on the size and complexity of the engagement. Planning generally includes the following activities:

- Assigning responsibilities to appropriate personnel during the planning phase
- Developing or updating background information on the client and the engagement
- Considering client significance to the firm
- Developing a planning document that includes the following:
 - Proposed work programs tailored to the specific engagement
 - Staffing requirements and the need for specialized knowledge
 - Consideration of the economic conditions affecting the client and its industry and their potential effect on the conduct of the engagement
 - The risks, including fraud considerations, affecting the client and the engagement and how the risks may affect the procedures performed
 - A budget that allocates sufficient time for the engagement to be performed in accordance with professional standards and the firm's quality control policies and procedures

3.35 *Policy 2: The engagement is performed, supervised, documented, and reported (or communicated) in accordance with the requirements of professional standards, applicable regulators, and the firm.* Single-Office CPA Firm implements this policy through the following procedures:

- Providing adequate supervision during the course of an engagement, including briefing the engagement team on the objectives of their work. The training, ability, and experience of the personnel are considered when assigning supervisors to the engagement.
- Requiring that a written work program be used in all engagements.
- Addressing significant issues arising during the engagement, considering their significance, and appropriately modifying the planned approach.
- Adhering to the guidelines set forth by the firm for the form and content of documentation of the work performed and conclusions reached. Such documentation includes standardized forms, checklists, and questionnaires used in the performance of engagements and explanations, when required, of how the firm integrates such aids into engagements.
- Requiring engagement documentation in accordance with professional standards, applicable regulatory requirements, and the firm's policies.

3.36 *Policy 3: Qualified engagement team members review work performed by other team members on a timely basis.* Single-Office CPA Firm implements this policy by adhering to the following guidelines established by the firm regarding review of the documentation of the work performed and conclusions reached, the financial statements and reports, and documentation of the review process:

- All reviewers are to have appropriate experience, competence, and responsibility.
- For each engagement, there is to be evidence of appropriate review of documentation of the work performed and conclusions reached, the financial statements, and the report.
- Engagement documentation is reviewed to determine whether the following have occurred:
 - The work has been performed in accordance with professional standards and regulatory and legal requirements.
 - Significant findings and issues have been raised for further consideration.
 - Appropriate consultations have taken place, and the resulting conclusions have been documented and implemented.
 - The nature, timing, and extent of work performed are appropriate and do not need revision.
 - The work performed supports the conclusions reached and is appropriately documented.
 - The evidence obtained is sufficient and appropriate to support the report.
 - The objectives of the engagement procedures have been achieved.

3.37 *Policy 4: Engagement teams complete the assembly of final engagement files on a timely basis.* Single-Office CPA Firm implements this policy by completing the assembly of final engagement files in accordance with professional standards and applicable regulatory requirements, if any.

3.38 *Policy 5: The firm maintains the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.* Single-Office CPA Firm implements this policy through the following procedures:

- Establishing and applying controls to accomplish the following:
 - Clearly determine when and by whom engagement documentation was prepared and reviewed.
 - Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means.
 - Prevent unauthorized changes to the engagement documentation.
 - Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

- Implementing procedures for properly distributing engagement documentation materials to engagement teams at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement
- Implementing procedures to restrict access to, and enable proper distribution and confidential storage of, hardcopy engagement documentation
- Requiring the use of passwords by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
- Implementing appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
 - Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
 - Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.
 - Enable the copies to be retrieved and printed as necessary.

3.39 *Policy 6: The firm retains engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.* Single-Office CPA Firm implements this policy through the following procedures:

- Retaining engagement documentation for a period of time sufficient to meet the requirements of the state board of accountancy and applicable professional standards
- Establishing procedures that
 - Enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time;
 - Provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed; and
 - Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

3.40 *Policy 7: The firm requires that consultation take place when appropriate; that sufficient and appropriate resources are available to enable appropriate consultation to take place; that all the relevant facts known to the engagement team are provided to those consulted; that the nature, scope, and conclusions of such consultations are documented; and that conclusions*

resulting from such consultations are implemented. Single-Office CPA Firm implements this policy through the following procedures:

- Consulting with those having appropriate knowledge, authority, and experience within the firm (or, where applicable, outside the firm) on significant technical, ethical, and other matters. Single-Office CPA firm uses advisory services provided by other firms, professional and regulatory bodies, and commercial organizations that provide relevant quality control services. Before using such services, the firm evaluates whether the external provider is qualified for that purpose.
- Informing personnel of the firm's consultation policies and procedures.
- Requiring sufficiently experienced engagement team members to identify matters for consultation or consideration during the engagement.
- Requiring consultation in specialized areas or situations with appropriate individuals within and outside the firm when matters such as the following arise:
 - The application of newly issued technical pronouncements
 - Industries with special accounting, auditing, or reporting requirements, including unusually complex employee benefit plans
 - Emerging practice problems
 - Choices among alternative generally accepted accounting principles upon initial adoption or when an accounting change is made
 - Reissuance of a report, consideration of omitted procedures after a report has been issued, or subsequent discovery of facts that existed at the date a report was issued
 - Filing requirements of regulators
 - Meetings with regulators at which the firm is to be called on to support the application of generally accepted accounting principles or generally accepted auditing standards that have been questioned
- Providing all professional personnel with access to adequate and current reference materials.
- Including all relevant facts, circumstances, the professional literature used, and conclusions reached in the engagement documentation of the work performed and conclusions reached.
- Documenting the issue on which consultation was sought and the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented. If there is an unresolved disagreement, an outside source may be consulted to assist in determining the appropriate application of accounting principles.

3.41 *Policy 8: The firm deals with and resolves differences of opinion, documents and implements conclusions reached, and does not release the report until the matter is resolved.* Single-Office CPA Firm implements this policy through the following procedures:

- Requiring that all differences of professional judgment among members of an engagement team be resolved by the engagement and the quality control partners, and the managing partner if necessary, and that the report not be released until the matter is resolved.
- Requiring that conclusions reached be appropriately documented. If members of the team continues to disagree with the resolution, they may disassociate themselves from the resolution of the matter and may document that a disagreement continues to exist.

3.42 *Policy 9: The firm has criteria for determining whether an engagement quality control review should be performed, evaluates all engagements against the criteria, performs an engagement quality control review for all engagements that meet the criteria, and completes the review before the report is released.* Single-Office CPA Firm implements this policy through the following procedures:

- Establishing criteria such as the following:
 - The identification of unusual circumstances or risks in an engagement or class of engagements as determined by the engagement partner or quality control partner.
 - An engagement quality control review is required by law or regulation.
- Evaluating all engagements against the criteria
- Performing an engagement quality control review for all engagements that meet the criteria

3.43 *Policy 10: The firm establishes procedures addressing the nature, timing, extent, and documentation of the engagement quality control review.* Single-Office CPA Firm implements this policy through the following procedures:

- Implementing procedures addressing the nature, timing, and extent of the review. The firm has concluded that performing an engagement quality control review is not necessary to obtain sufficient appropriate audit evidence for audit engagements; therefore, the engagement quality control review does not need to be completed before the date of the auditor's report. When the engagement quality control review results in additional audit procedures being performed, the date of the auditor's report is changed to the date by which sufficient appropriate audit evidence has been obtained. The firm's procedures require that for audit and attestation engagements, the engagement quality control reviewer do the following:
 - Discuss significant accounting, auditing, and financial reporting issues with the engagement partner, including matters for which there has been consultation.

- Discuss with the engagement partner the engagement team's identification and audit of high-risk assertions, transactions and account balances.
 - Confirm with the engagement partner that there are no significant unresolved issues.
 - Review selected working papers relating to the significant judgments the engagement team made and the conclusions they reached.
 - Review documentation of the resolution of significant accounting, auditing, or financial reporting issues, including documentation of consultation with firm personnel or external sources.
 - Review the summary of uncorrected misstatements related to known and likely misstatements.
 - Review additional engagement documentation to the extent considered necessary.
 - Read the financial statements and the report and consider whether the report is appropriate.
 - Complete the review before the release of the report. The review may be conducted at appropriate stages during the engagement.
 - Determine whether the issues raised in the review indicate a need to change the auditor's report date.
- Resolving conflicting opinions between the engagement partner and the engagement quality control reviewer regarding significant matters. The policy requires documentation of the resolution of conflicting opinions before the release of the audit report.
 - Implementing procedures addressing documentation by the engagement quality control reviewer. The firm's procedures require documentation of the following:
 - The procedures required by the firm's policies on engagement quality control review have been performed.
 - The engagement quality control review has been completed before the report is released.
 - No matters have come to the attention of the engagement quality control reviewer that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

3.44 *Policy 11: The firm establishes criteria for the eligibility of engagement quality control reviewers.* Single-Office CPA Firm implements this policy by establishing the following criteria for an engagement quality control reviewer:

- Is selected by the quality control partner or the managing partner
- Has sufficient technical expertise and experience

- Carries out his or her responsibilities with objectivity and due professional care without regard to the relative positions of the audit engagement partner and the engagement quality control reviewer
- Meets the independence requirements relating to the engagements reviewed, even though the engagement quality control reviewer is not a member of the engagement team
- Does not make decisions for the engagement team or participate in the performance of the engagement except that the engagement partner may consult the engagement quality control reviewer at any stage during the engagement

When the firm does not have suitably qualified personnel to perform the engagement quality control review, the firm contracts with a suitably qualified external person to perform the engagement quality control review.

MONITORING

3.45 The objective of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

3.46 Single-Office CPA Firm satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 3.47–3.56.

3.47 *Policy 1: The firm assigns responsibility for the monitoring process, including performance, to a partner or competent individual.* Single-Office CPA Firm implements this policy through the following procedures:

- Designating a partner or senior personnel to be responsible for quality assurance, including ensuring that the firm's quality control policies and procedures and its methodologies remain relevant and adequate. Factors to be considered include the following:
 - Mergers and divestitures of portions of the practice
 - Changes in professional standards or other regulatory requirements applicable to the firm's practice
 - Results of inspections and peer reviews
 - Review of litigation and regulatory enforcement actions against the firm and its personnel
 - Changes in applicable AICPA membership requirements
- Determining whether personnel have been appropriately informed of their responsibilities for maintaining the firm's standards of quality in performing their duties.
- Identifying the need to do the following:
 - Revise policies and procedures related to the other elements of quality control because they are ineffective or inappropriately designed.
 - Improve compliance with firm policies and procedures related to the other elements of quality control.

3.48 *Policy 2: The firm performs monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.*

3.49 For purposes of illustrating Policy 2, two scenarios are described. Scenario 1 illustrates how Single-Office CPA Firm would satisfy the objective of Policy 2 by reviewing engagements throughout the year. Scenario 2 illustrates how Single-Office CPA Firm would implement Policy 2 by performing an annual inspection, thereby reviewing engagements during a designated period in the year.

3.50 *Scenario 1: Monitoring by Reviewing Engagements Throughout the Year.* Single-Office CPA Firm implements Policy 2 through the following procedures:

- Designating a partner or management-level individual not previously associated with the engagement to perform either a preissuance or postissuance review of the engagement.
- Establishing the approach for performing preissuance or postissuance reviews, for example, the comprehensiveness of the review and the frequency for summarizing findings (such as monthly or quarterly). The comprehensiveness of the review of selected engagements is similar to that performed in an inspection or peer review.

- Designating the forms and checklists to be used during the engagement and functional element reviews and the extent of the documentation required. (Examples of functional elements are the human resources function and the firm's library.)
- Selecting a cross-section of engagements at the beginning of the monitoring year for preissuance or postissuance review and reevaluating that selection throughout the year as circumstances dictate. Criteria used for selecting engagements include the following:
 - Significant specialized industries with emphasis on high-risk engagements
 - Audits of the financial statements of employee benefit plans
 - First-year engagements
 - Significant client engagements
 - Level of service performed (that is, audit and attest, review, or compilation)
 - Engagements performed by all partners and other management-level personnel having accounting and auditing responsibilities
 - Engagements performed under *Government Auditing Standards* (Yellow Book engagements)
 - Engagements for which there have been complaints or allegations from firm personnel, clients, or other third parties that the work performed by the firm failed to comply with professional standards, regulatory requirements, or the firm's system of quality control
 - Engagements in which there were significant disagreements between the review partner and the engagement partner
- Reviewing the selected engagements. Deficiencies identified as a result of this process are summarized and evaluated to determine whether the following are necessary:
 - Additional emphasis on specific areas or industries in future engagements
 - Modifications to existing policies and procedures to prevent the deficiencies noted from recurring
- Reviewing other engagement files at least annually for compliance with the firm's quality control policies and procedures including reviewing correspondence regarding consultation on independence, integrity, and objectivity matters (for example, assessments of significant clients) and acceptance and continuance decisions.
- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.

- Preparing a summary of the deficiencies noted resulting from the preissuance and postissuance reviews so that the partner may incorporate any recommended changes into the firm's policies and procedures.
- Communicating to all professional personnel the deficiencies noted and related changes in quality control procedures.
- Following up on planned corrective actions to determine whether the actions were taken as planned and whether they achieved the intended objectives.

3.51 *Scenario 2: Monitoring by Inspecting a Sample of Engagements During a Designated Period of the Year.* Single-Office CPA Firm implements Policy 2 through the following procedures:

- Designating a partner to be responsible for performing an annual inspection using guidance prepared by the AICPA for performing inspection procedures. These procedures include reviewing a cross-section of engagements using the following criteria in selecting engagements:
 - Significant specialized industries with emphasis on high-risk engagements
 - Audits of the financial statements of employee benefit plans
 - First-year engagements
 - Significant client engagements
 - Level of service performed (that is, audit and attest, review, or compilation)
 - Engagements performed by all partners and other management-level personnel having accounting and auditing responsibilities
 - Engagements performed under *Government Auditing Standards* (Yellow Book engagements)
 - Engagements for which there have been complaints or allegations from firm personnel, clients, or other third parties that the work performed by the firm failed to comply with professional standards, regulatory requirements, or the firm's system of quality control
 - Engagements in which there were significant disagreements between the quality review partner and the engagement partner
- Establishing an approach and timetable for performing the inspection procedures and determining the forms and checklists to be used during the inspection and the extent of documentation required.
- Deciding how long to retain detailed inspection documentation (as opposed to summaries).
- Reviewing correspondence regarding consultation on independence, integrity, and objectivity matters and acceptance and continuance decisions.

- Reviewing the resolution of matters reported by professional personnel regarding independence to determine that matters have been appropriately considered and resolved.
- Selecting a sample of engagements for review to determine compliance with the firm's quality control policies and procedures, reevaluating that selection throughout the process, and reviewing the selected engagements.
- Preparing a summary inspection report for the partner or management group that evaluates the overall results of the inspection and sets forth any recommended changes that should be made to the firm's policies and procedures.
- Reviewing the recommended corrective actions and reaching final conclusions about the actions to be taken.
- Communicating inspection findings and quality control changes to all professional personnel.
- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s).

3.52 In addition to the procedures described under Scenarios 1 or 2, Single-Office CPA Firm also implements Policy 2 through the following procedures:

- Reviewing and evaluating firm practice aids, such as audit programs, forms, and checklists, and considering whether they reflect recent professional pronouncements
- Providing information during staff meetings regarding new professional standards, regulatory requirements, and the related changes that should be made to firm practice aids
- Reviewing, or designating a management-level individual to be responsible for reviewing, the professional development policies and procedures to determine whether they are appropriate, effective, and meet the needs of the firm
- Reviewing, or designating a management-level individual to review summaries of the CPE records of the firm's professional personnel to evaluate each individual's compliance with the requirements of the AICPA and other applicable regulators
- Reviewing other administrative and personnel records pertaining to the quality control elements
- Soliciting information from the firm's personnel during staff meetings regarding the effectiveness of training programs

3.53 *Policy 3: The firm communicates (a) deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action to relevant engagement partners and other appropriate personnel and (b) the results of the monitoring of its quality control system process to relevant firm personnel at least annually.* Single-Office CPA Firm implements this policy through the following procedures:

- Preparing a summary report for the partners that evaluates the overall results of the monitoring and sets forth any recommended changes that should be made to the firm's policies and procedures
- Reviewing the recommended corrective actions and reaching final conclusions as to the actions to be taken
- Communicating to all professional personnel the deficiencies noted and the related changes in quality control procedures
- Following up on planned corrective actions to determine whether those actions were taken and whether they achieved the intended objective(s)

3.54 *Policy 4: The firm deals appropriately with complaints and allegations.* Single-Office CPA Firm implements this policy through the following procedures:

- Having the managing partner inform personnel that they may raise any concerns regarding complaints or allegations about noncompliance with professional standards, regulatory and legal requirements, or the firm's system of quality control with any partner without fear of reprisals.
- Having a partner who is not otherwise involved in the engagement investigate the following:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
 - Allegations of noncompliance with the firm's system of quality control
 - Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations
- Documenting complaints and allegations and the responses to them.

3.55 *Policy 5: The firm prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control.* Single-Office CPA Firm implements this policy by designing its summary monitoring report to provide evidence of the operation of each element of its system of quality control, including the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
 - Adherence to professional standards and regulatory and legal requirements
 - Whether the quality control system has been appropriately designed and effectively implemented
 - Whether the firm's quality control policies and procedures have been appropriately applied so that reports that are issued by the firm or engagement partners are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be

3.56 *Policy 6: The firm retains documentation providing evidence of the operation of the system of quality control for an appropriate period of time.* Single-Office CPA Firm implements this policy by requiring retention of the summary monitoring report for a period of time sufficient to meet the firm's peer review or other regulatory requirements.

CHAPTER 4: SYSTEM OF QUALITY CONTROL FOR A CPA FIRM'S ACCOUNTING PRACTICE— SOLE PRACTITIONER

4.01 This chapter describes how a sole practitioner (Sole Practitioner, CPA) implements each element of quality control in her accounting practice. Sole Practitioner, CPA, is a hypothetical firm of which Sole Practitioner, CPA, is the sole owner. The firm has no professional staff; however, on occasion Sole Practitioner, CPA, hires per-diem professionals. Her accounting practice consists only of engagements subject to Statements on Standards for Accounting and Review Services (SSARSs). She uses practice aids that have been subjected to peer review in accordance with standards established by the AICPA. Sole Practitioner, CPA, uses per-diem personnel to assist her and recognizes that her policies and procedures would have to change if she were to perform audit or attest engagements or hire full-time or part-time professional staff.

QUALITY CONTROL POLICIES AND PROCEDURES

4.02 The firm's system of quality control consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The policies and procedures are required to be documented. Sole Practitioner, CPA, documents her system of quality control by filling out checklists and questionnaires such as those included in the AICPA Peer Review Program Manual. Sole Practitioner, CPA, reviews the documentation at least annually and updates it as necessary.

4.03 The firm should communicate its quality control policies and procedures to its personnel. Effective communication includes the following:

- A description of quality control policies and procedures and the objectives they are designed to achieve
- The message that each individual has a personal responsibility for quality

4.04 Sole Practitioner, CPA, meets this requirement with regard to herself by annually reviewing the checklists and questionnaires used to document each element of her system of quality control. Sole Practitioner, CPA, communicates her policies and procedures to per-diem professionals when they are initially contracted for an engagement by holding a discussion with them and follows up on individual engagements. Sole Practitioner, CPA, requires per-diem personnel to be familiar with and to comply with these policies and procedures.

LEADERSHIP RESPONSIBILITIES FOR QUALITY WITHIN THE FIRM (THE “TONE AT THE TOP”)

4.05 The objective of the leadership responsibilities element of a system of quality control is to promote an internal culture based on the recognition that quality is essential in performing engagements. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 4.06–4.08.

4.06 *Policy 1: I am ultimately responsible for the firm's system of quality control.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Accepting responsibility for the firm's system of quality control
- Educating herself about requirements for a system of quality control
- Designing and implementing policies and procedures required for her firm's system of quality control

4.07 *Policy 2: Commercial considerations do not override the quality of the work performed.* Sole Practitioner, CPA, implements this policy by continually evaluating client relationships and specific engagements so that commercial considerations do not override the objectives of the system of quality control.

4.08 *Policy 3: I devote sufficient and appropriate resources for the development, communication, and support of the firm's quality control policies and procedures.* Sole Practitioner, CPA, implements this policy by reviewing and updating the quality control policies, procedures, and documentation on an annual basis.

RELEVANT ETHICAL REQUIREMENTS

4.09 The objective of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 4.10–4.13.

4.10 *Policy 1: I adhere to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the GAO (U.S. Government Accountability Office), and any other applicable regulators.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Subscribing to the AICPA *Professional Standards* service.

- Consulting the AICPA Web site for information about changes in professional ethics and independence standards.
- Reviewing unpaid client fees to ascertain whether any outstanding amounts impair the firm's independence.
- Reviewing relevant pronouncements published in the *Journal of Accountancy* relating to independence, integrity, and objectivity and retaining relevant issues of the *Journal of Accountancy*.
- Attending periodic professional training in ethics and independence.
- Complying with SSARSs by disclosing in the accountant's compilation report instances in which the firm is not independent.
- Considering the significance of each client to the firm. In broad terms, the significance of a client to a firm refers to relationships that could diminish a practitioner's objectivity and independence in performing attest services. In determining the significance of a client, the firm considers (a) the amount of time the partner devotes to the engagement and (b) the effect that losing the client would have on the firm.

4.11 *Policy 2: I communicate independence requirements to per-diem professionals.* Sole Practitioner, CPA, implements this policy by making per-diem personnel aware of financial, family, business, and other relationships that may be prohibited by applicable requirements.

4.12 *Policy 3: I establish procedures to identify and evaluate possible threats to independence and objectivity and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards. I withdraw from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Considering relevant information about client engagements, including the scope of services, to enable her to evaluate the overall impact on independence
- Consulting with AICPA Ethics Hotline with concerns about possible threats to independence
- Accumulating and communicating relevant information to per-diem personnel as appropriate so that the following can occur:
 - Sole Practitioner, CPA, and per-diem personnel can readily determine whether they satisfy independence requirements.
 - Sole Practitioner, CPA, can maintain and update information relating to independence.
 - Sole Practitioner, CPA, can take appropriate action regarding identified threats to independence.

- Requiring per-diem personnel to promptly notify her of independence breaches of which they become aware, and circumstances and relationships that create a threat to independence, so that appropriate action can be taken
- Documenting any safeguards applied to eliminate threats to independence or reduce them to an acceptable level
- Withdrawing from the engagement if effective safeguards to reduce threats to independence to an acceptable level cannot be applied

4.13 *Policy 4: I confirm, in writing, my compliance with policies and procedures on independence and require written confirmation from all per-diem professionals required to be independent by relevant requirements.* Sole Practitioner, CPA, implements this policy by signing a step on each engagement program attesting to her independence and requiring per-diem personnel to do the same.

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS AND SPECIFIC ENGAGEMENTS

4.14 The objective of the quality control element that addresses acceptance and continuance of client relationships and specific engagements is to establish criteria for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for a client. A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk. Accordingly, it is important that a firm be aware that the integrity and reputation of a client's management could reflect the reliability of the client's accounting records and financial representations and, therefore, affect the firm's reputation or involvement in litigation. A firm's policies and procedures related to the acceptance and continuance of client relationships and specific engagements should provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where it

- Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance, and the risks associated with providing professional services in the particular circumstances;
- Is competent to perform the engagement and has the capabilities and resources to do so;
- Can comply with legal and ethical requirements; and
- Has reached an understanding with the client regarding the services to be performed.

4.15 Sole Practitioner, CPA, satisfies this objective, both with respect to the initial period for which the firm is performing its service and for subsequent periods, by establishing and maintaining the policies and procedures described in paragraphs 4.16–4.20.

4.16 *Policy 1: I evaluate factors that have a bearing on management's integrity and consider the risk associated with providing professional services in particular circumstances.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Obtaining information such as the following before accepting or continuing a client:
 - The nature and purpose of the services to be provided
 - The identity of the client's principal owners, key management, related parties, and those charged with its governance
 - The nature of the client's operations, including its business practices, from sources such as prior-year reports, internally generated financial statements (if applicable), income tax returns, and credit reports
 - Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control over financial reporting
- Inquiring of third parties such as bankers, factors, and legal counsel about management's business reputation and integrity.
- Communicating with the predecessor accountant when required or suggested by professional standards.¹
- Evaluating the information obtained regarding management's integrity.
- Evaluating the risk of providing review services to significant clients or to other clients for which Sole Practitioner's, CPA, objectivity or the appearance of independence may be impaired. In determining the significance of a client, Sole Practitioner, CPA, considers the amount of time she devotes to the engagement and the effect that losing the client would have on her practice.

4.17 *Policy 2: I evaluate whether the engagement can be completed with professional competence; undertake only those engagements for which the firm has the capabilities, resources, and professional competence to complete; and evaluate, at the end of specific periods or upon*

¹ AR section 400, *Communications Between Predecessor and Successor Accountants* (AICPA, Professional Standards, vol. 2), provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant. It also requires a successor accountant who becomes aware of information that leads him or her to believe the financial statements reported on by the predecessor accountant may require revision to request that the client communicate this information to the predecessor accountant.

occurrence of certain events, whether the relationship should be continued. Sole Practitioner, CPA, implements this policy through the following procedures:

- Establishing a cut-off date by which evaluations of engagements should be performed, for example, before work on the current-year engagement begins
- Considering conditions, such as the following, that require reevaluation of a client or specific engagement and obtaining the relevant information to determine whether the relationship should be continued:
 - Significant changes in the client, for example, a major change in ownership, senior client personnel, directors, advisers, the nature of the business, or the financial stability of the client.
 - Changes in the nature or scope of the engagement, including requests for additional services.
 - Client significance.
 - Matters that would have caused the firm to reject the client or engagement had such conditions existed at the time of the initial acceptance. If such matters exist, Sole Practitioner, CPA, considers the professional and legal responsibilities that apply to the circumstances and the possibility of withdrawing from the engagement or both the engagement and the client relationship.
 - The client's delinquency in paying fees. (This also may affect the firm's independence.)
- Determining if she has, or can reasonably obtain, the knowledge and expertise to perform the engagement
- Evaluating the information obtained regarding the engagement, making the acceptance or continuance decision, and documenting her evaluation or conclusion in a memorandum or by signing off next to the relevant item in a practice aid

4.18 *Policy 3: I obtain an understanding with the client regarding the services to be performed.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Adhering to all requirements set forth in professional standards regarding obtaining an understanding with the client
- Requiring that the understanding with the client be documented either through an engagement letter or in a memorandum

4.19 *Policy 4: I follow established procedures on withdrawal from an engagement or from both the engagement and the client relationship.* Sole Practitioner, CPA, implements this policy by discussing the issues and her conclusion with the appropriate level of the client's management

and those charged with its governance. If she considers it necessary, she also discusses her decision with her attorney.

4.20 *Policy 5: I document how issues relating to acceptance or continuance of client relationships and specific engagements were resolved.* Sole Practitioner, CPA, implements this policy by documenting, in a memorandum to the engagement files, significant issues, consultations, conclusions, and the basis for the conclusions relating to acceptance or continuance of client relationships and specific engagements.

HUMAN RESOURCES

4.21 The objective of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (b) to enable the firm to issue reports that are appropriate in the circumstances. Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 4.22–4.23.

4.22 *Policy 1: I hire per-diem personnel of integrity who possess the characteristics that enable them to perform competently.* Sole Practitioner, CPA, implements this policy by setting criteria, regarding such factors as education, certification or licensure, and experience, that per-diem personnel must meet to be hired.

4.23 *Policy 2: I maintain the knowledge, skills, and abilities required in the circumstances by participating in general and industry-specific continuing professional education (CPE) and professional development activities that enable me to accomplish my responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state boards of accountancy, and other applicable regulators. I also monitor the compliance of per-diem employees with CPE requirements.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Maintaining the competencies necessary to accomplish responsibilities related to each of the firm's engagements
- Establishing a professional development program that takes into account the requirements of the AICPA and state boards of accountancy
- Participating in external professional development programs, including graduate-level and self-study courses
- Joining and becoming an active member of professional organizations

- Serving on professional committees, writing for professional publications on topics she is knowledgeable about, and participating in other professional activities
- Considering changes in the applicable professional standards when determining her professional development program
- Setting criteria that per-diem personnel must meet to competently perform engagements, such as the following examples:
 - Determining that per-diem personnel are in compliance with the applicable professional education requirements of the AICPA, state boards of accountancy, and state CPA societies
 - Obtaining and retaining documentation of such compliance
- Evaluating the knowledge and expertise required to perform an engagement prior to accepting the client or engagement
- Reading professional publications, such as state society journals, to keep abreast of changes in accounting standards and any industry-specific pronouncements that affect the client
- Consulting the AICPA Web site for information about changes in professional standards

ENGAGEMENT PERFORMANCE

4.24 The objective of the engagement performance element of quality control is to provide the firm with reasonable assurance (a) that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and (b) that the firm or the practitioner-in-charge issues reports that are appropriate in the circumstances. Policies and procedures for engagement performance should address all phases of the design and execution of the engagement, including engagement performance, supervision responsibilities, and review responsibilities. Policies and procedures also should require that consultation takes place when appropriate. In addition, a policy should establish criteria against which all engagements are to be evaluated to determine whether an engagement quality control review should be performed. Sole Practitioner, CPA, satisfies these objectives by establishing and maintaining the policies and procedures described in paragraphs 4.25–4.32.

4.25 *Policy 1: I plan engagements to meet professional standards, regulatory requirements, and the firm's requirements.* Sole Practitioner, CPA, implements this policy by adhering to professional standards regarding the planning process and the extent of documentation of the planning, if applicable. Engagement planning considerations may include the following:

- Developing or updating client information.
- Assessing the significance of the client to her firm.

- Obtaining an engagement letter for engagements performed under SSARSS. AR section 100, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2), requires the accountant to either issue a compilation report or document an understanding with the entity through the use of an engagement letter when the accountant submits financial statements to a client that are not expected to be used by a third party.
- Reviewing prior financial statements and accountants' reports.
- Using work programs and applicable reporting and disclosure checklists.

4.26 *Policy 2: I perform, supervise, review, document, and report (or communicate) in accordance with the requirements of professional standards.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Requiring the use of appropriate practice aids in all engagements
- Maintaining the availability of current practice aids and AICPA professional standards
- Briefing per-diem personnel on the engagement so that they understand the objectives of their work
- Documenting the work performed in accordance with professional standards and the firm's policy
- Supervising per-diem personnel as appropriate based on the following:
 - Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation
 - Understanding of professional standards and regulatory and legal requirements
 - Technical knowledge, including knowledge of relevant information technology
 - Knowledge of relevant industries in which the client operates
 - Ability to apply professional judgment
 - Understanding of the firm's quality control policies and procedures
 - Experience level
- Reviewing and initialing all engagement documentation prepared by per-diem personnel

4.27 *Policy 3: I complete the assembly of final engagement files on a timely basis.* Sole Practitioner, CPA, implements this policy by completing the assembly of final engagement files on a timely basis in accordance with professional standards and applicable regulatory requirements, if any.

4.28 *Policy 4: I maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Establishing and applying controls to do the following:
 - Clearly determine when and by whom engagement documentation was prepared and reviewed.
 - Protect the integrity of the information at all stages of the engagement.
 - Prevent unauthorized changes to the engagement documentation.
 - Allow access to the engagement documentation by per-diem personnel and other authorized parties as necessary to properly discharge their responsibilities.
- Tracking the distribution of engagement documentation materials to the per-diem personnel at the start of the engagement, preparing engagement documentation during the engagement, and assembling final documentation at the end of the engagement
- Restricting access to, and enabling proper distribution and confidential storage of, hardcopy engagement documentation
- Using passwords or data encryption, or both, to restrict access to electronic engagement documentation to authorized users
- Using appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Implementing procedures regarding original paper documents that have been electronically scanned or otherwise copied to another media that accomplish the following:
 - Generate copies that contain the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
 - Integrate the copies into the engagement files, including indexing and signing off on the copies as necessary.
 - Enable the copies to be retrieved and printed as necessary.

4.29 *Policy 5: I retain engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Retaining engagement documentation for a period of time sufficient to meet the requirements of the state board of accountancy and applicable professional standards

- Enabling the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time
- Providing, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed
- Enabling authorized external parties to access and review specific engagement documentation for quality control or other purposes

4.30 *Policy 6: I require that consultation take place when appropriate; I make sufficient and appropriate resources available to enable appropriate consultation to take place; I provide to those consulted all the relevant facts known to me; I document the nature, scope, and conclusions of such consultations; and I implement conclusions resulting from such consultations.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Maintaining current technical references to assist in resolving practice problems
- Referring to the AICPA's Technical Hotline or other qualified individuals if a practice problem arises for which the firm needs additional expertise
- Requiring that documentation of consultation include the following:
 - All relevant facts and circumstances about the issue on which consultation was sought.
 - References to professional literature used in the analysis of the matter.
 - The results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented. This documentation is retained with the engagement documentation.

4.31 *Policy 7: I deal with and resolve differences of opinion; I document and implement the conclusions reached; and I do not release the report until the matter is resolved.* Sole Practitioner, CPA, implements this policy by (a) evaluating issues of professional judgment when differences of opinion arise with per-diem personnel, with those consulted, or with an external reviewer and (b) resolving the matter before releasing the report. If persons involved in the engagement continue to disagree with the resolution, they may disassociate themselves from the resolution of the matter and document that a disagreement continues to exist.

4.32 *Policy 8: I have criteria for determining whether an engagement quality control review should be performed; I evaluate all engagements against the criteria before I accept the engagement; I contract with a qualified external person to perform the engagement quality control review; and I do not release the report until the review is completed.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Establishing the following criteria for determining whether an engagement quality control review should be performed:
 - The engagement is subject to Statements on Auditing Standards or Statements on Standards for Attestation Engagements.
 - An initial engagement for a client is in a specialized industry in which Sole Practitioner, CPA, has had no previous experience.
 - An engagement quality control review is required by law or regulation.
- Evaluating all engagements against the criteria
- Contracting with a qualified external person to perform the engagement quality control review
- Not releasing the report until the review is completed

MONITORING

4.33 The objective of the monitoring element of a system of quality control is to provide the firm with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

4.34 Sole Practitioner, CPA, satisfies this objective by establishing and maintaining the policies and procedures described in paragraphs 4.35–4.39.

4.35 *Policy 1: I perform monitoring procedures that are sufficiently comprehensive to enable me to assess compliance with all applicable professional standards and the firm's quality control policies and procedures.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Performing a postissuance review of selected engagements at least annually²
- Summarizing the findings from the firm's monitoring procedures at least annually and considering the systemic causes of findings that indicate improvements are needed
- Determining any corrective actions or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures and taking those actions, including necessary modifications to the quality control system, on a timely basis
- Reviewing compliance with the firm's policies and procedures related to relevant ethical responsibilities, including independence, human resources, acceptance and continuance of client relationships and specific engagements, and engagement performance
- Reviewing all policies and procedures and revising those affected by changes in professional standards or the nature of her practice
- Reviewing and determining that the firm's practice aids are current and reflect recent professional pronouncements and changes in her practice
- Reviewing CPE records to determine whether the classroom training and self-study programs she uses are appropriate for the firm's practice
- Reviewing CPE records to determine compliance with the requirements of the AICPA and other applicable regulatory agencies

4.36 *Policy 2: I deal appropriately with complaints and allegations.* Sole Practitioner, CPA, implements this policy through the following procedures:

- Investigating the following:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
 - Allegations of noncompliance with the firm's system of quality control
 - Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations
- Documenting complaints and allegations and the responses to them

² A postissuance review may be performed as part of an inspection. A sole proprietor may consider engaging another CPA to perform the inspection to obtain a fresh look at the engagement. See paragraph 3.51, "Scenario 2: Monitoring by Inspecting a Sample of Engagements During a Designated Period of the Year," for a description of how a firm considers and evaluates, on an ongoing basis, compliance with a firm's policies and procedures by performing an annual inspection. Note that a preissuance review by the sole proprietor does not satisfy the monitoring requirements.

4.37 *Policy 3: I prepare appropriate documentation to provide evidence of the operation of each element of the firm's system of quality control.* Sole Practitioner, CPA, implements this policy by documenting evidence of the operation of each element of the firm's system of quality control by preparing a memorandum of the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be subject to postissuance review
- A record of the evaluation of the following:
 - Adherence to professional standards and regulatory and legal requirements
 - Whether the quality control system has been appropriately designed and effectively implemented
 - Whether the firm's quality control policies and procedures have been appropriately applied so that reports that are issued by the firm are appropriate in the circumstances
- Identification of the deficiencies noted, an evaluation of their effects, and the basis for determining whether further action is necessary and what that action should be

4.38 Although the form and content of that documentation is a matter of judgment, the illustration in Table 1 in this chapter is an example of such documentation.

4.39 *Policy 4: I retain documentation of evidence of the operation of the system of quality control for an appropriate period of time.* Sole Practitioner, CPA, implements this policy by requiring retention of the summary report for a period of time sufficient to meet the firm's peer review or other regulatory requirements.

Table 1: Summary of Quality Control Monitoring For the Calendar Year 20XX

<i>Element of Quality Control and Applicable Policies</i>	<i>Reviewer's Initials and Date Reviewed</i>	<i>Location of Additional Documentation</i>
Leadership Responsibilities for Quality Within the Firm		These policies are evidenced by the overall operation of the firm's system of quality control.
Relevant Ethical Requirements		
<i>Policy 1.</i> Adhering to relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, and other applicable regulators	JB 6/30/XX	Independence confirmation files

<i>Element of Quality Control and Applicable Policies</i>	<i>Reviewer's Initials and Date Reviewed</i>	<i>Location of Additional Documentation</i>
<i>Policy 2.</i> Communicating independence requirements to per-diem professionals and, where applicable, others subject to them	JB 6/30/XX	Independence confirmation files
<i>Policy 3.</i> Establishing procedures to help mitigate possible threats to my independence and objectivity	JB 6/30/XX	Independence confirmation files
<i>Policy 4.</i> Confirming, in writing, my compliance with policies and procedures on independence and obtaining written confirmation from all per-diem professionals required to be independent by relevant requirements	JB 6/30/XX	Independence confirmation files
Acceptance and Continuance of Client Relationships and Specific Engagements		
<i>Policy 1.</i> Evaluating factors that have a bearing on management's integrity and considering the risk associated with providing professional services in particular circumstances	JB 6/30/XX	Client acceptance files and client engagement files
<i>Policy 2.</i> Accepting or continuing to perform only those engagements that I can complete with professional competence and evaluating whether the relationship should be continued	JB 6/30/XX	Engagement files
<i>Policy 3.</i> Obtaining an understanding with the client regarding services to be performed	JB 6/30/XX	Engagement files
<i>Policy 4.</i> Following established procedures on withdrawal from an engagement or from both the engagement and the client relationship	JB 6/30/XX	Not applicable for year ended 20XX
<i>Policy 5.</i> Documenting how issues relating to acceptance or continuance of client relationships and specific engagements were resolved	JB 6/30/XX	Client acceptance files and client engagement files
Human Resources		
<i>Policy 1.</i> Hiring per-diem personnel of integrity who possess the characteristics that enable them to perform competently	JB 6/30/XX	Personnel files
<i>Policy 2.</i> (a) Maintaining the knowledge, skills, and abilities required in the circumstances by participating in general and industry-specific continuing professional education (CPE) and professional development activities that enable me to accomplish my responsibilities and satisfy	JB 6/30/XX	Personnel files

<i>Element of Quality Control and Applicable Policies</i>	<i>Reviewer's Initials and Date Reviewed</i>	<i>Location of Additional Documentation</i>
applicable CPE requirements of the AICPA, state CPA society, state boards of accountancy, and other applicable regulators and (b) monitoring for compliance the CPE requirements of per-diem employees		
Engagement Performance		
<i>Policy 1.</i> Planning engagements to meet professional standards, regulatory requirements, and the firm's requirements	JB 6/30/XX	Engagement files
<i>Policy 2.</i> Performing, supervising, reviewing, documenting, and reporting (or communicating) in accordance with the requirements of professional standards	JB 6/30/XX	Engagement files
<i>Policy 3.</i> Completing the assembly of final engagement files on a timely basis	JB 6/30/XX	Engagement files
<i>Policy 4.</i> Maintaining the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation	JB 6/30/XX	Engagement files
<i>Policy 5.</i> Retaining engagement documentation for a period of time sufficient to meet the needs of the firm, professional standards, laws, and regulations	JB 6/30/XX	Engagement files
<i>Policy 6.</i> Requiring that consultation take place when appropriate; making sufficient and appropriate resources available to enable appropriate consultation to take place; providing to those consulted all the relevant facts known to me; documenting the nature, scope, and conclusions of such consultations; and implementing conclusions resulting from such consultations	JB 6/30/XX	Engagement files
<i>Policy 7.</i> Dealing with and resolving differences of opinion; documenting and implementing the conclusions reached; and not releasing the report until the matter is resolved	JB 6/30/XX	Engagement files
<i>Policy 8.</i> Evaluating all engagements against my criteria for an engagement quality control review; contracting with a qualified external person to perform the engagement quality control review; and not releasing the report until the review is completed	JB 6/30/XX	Client acceptance files

<i>Element of Quality Control and Applicable Policies</i>	<i>Reviewer's Initials and Date Reviewed</i>	<i>Location of Additional Documentation</i>
Monitoring		
<i>Policy 1.</i> Performing monitoring procedures that are sufficiently comprehensive to enable me to assess compliance with all applicable professional standards and the firm's quality control policies and procedures	JB 6/30/XX	Monitoring files
<i>Policy 2.</i> Dealing appropriately with complaints and allegations	JB 6/30/XX	Engagement files
<i>Policy 3.</i> Preparing appropriate documentation to provide evidence of the operation of each element of the firm's system of quality control	JB 6/30/XX	Monitoring files
<i>Policy 4.</i> Retaining documentation of evidence of the operation of the system of quality control for an appropriate period of time	JB 6/30/XX	Monitoring files

CHAPTER 5: SYSTEM OF QUALITY CONTROL FOR AN ALTERNATIVE PRACTICE STRUCTURE

5.01 An alternative practice structure, as referred to in this practice aid, is a nontraditional structure in the practice of public accounting that contains an attest and a nonattest portion. The attest portion is conducted through a firm owned and controlled by CPAs (a *closely aligned CPA firm*). The nonattest portion is conducted through a separate issuer or nonissuer firm owned and controlled by individuals who are not CPAs (a *non-CPA-owned entity*¹). The non-CPA-owned entity may be an issuer or a nonissuer. Alternative practice structures are described in Interpretation No. 101-14, “The Effect of Alternative Practice Structures on the Applicability of Independence Rules,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.16), which is included as Appendix B of this practice aid.

5.02 The quality control policies and procedures established by a closely aligned CPA firm that may or may not perform audit services are illustrated in Chapters 2 and 3, as applicable. Additional quality control policies and procedures relevant to alternative practice structures may be necessary when certain portions of the CPA firm’s system of quality control (a) reside at the non-CPA-owned entity or (b) operate in conjunction with the system of quality control of the non-CPA-owned entity.

5.03 Elements of quality control that might reside in a non-CPA-owned entity include the following:

- Relevant ethical requirements
- Human resources
- Monitoring of relevant ethical requirements and human resources

For example, the non-CPA-owned entity may be responsible for hiring personnel for both firms.

5.04 This chapter describes how Non-CPA-Owned Entity and Closely Aligned CPA Firm, hypothetical firms that are organized in an alternative practice structure, implement incremental quality control policies and procedures to address the previously mentioned elements of quality

¹ A *non-CPA-owned entity* is an entity that is closely aligned to a CPA firm through common employment; leasing of employees, equipment, or facilities; or other similar arrangements. In addition to one or more professional service subsidiaries or divisions that offer nonattest professional services (for example, tax, personal financial planning, and management consulting), a non-CPA-owned entity may have subsidiaries or divisions such as a bank, insurance company, or broker-dealer.

control that reside at Non-CPA-Owned Entity. Closely Aligned CPA Firm has no issuer clients² and implements the policies and procedures described in Chapter 2 of this practice aid.

QUALITY CONTROL POLICIES AND PROCEDURES

5.05 *Policy 1: The top-tier company³ maintains a system of quality control.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Designating a qualified individual to be responsible for the following:
 - Designing and directing the quality control activities at the top-tier company
 - Disseminating information to all subsidiaries and affiliated entities, all subsidiaries associated with CPA firms, and all CPA firms closely aligned with company subsidiaries
- Providing all company personnel and indirect superiors⁴ with access to the company's quality control policies and procedures

RELEVANT ETHICAL REQUIREMENTS

5.06 The objective of the relevant ethical requirements element of a system of quality control is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when discharging professional responsibilities. Relevant ethical requirements include independence, integrity, and objectivity. Closely Aligned CPA Firm satisfies this objective by ensuring that Non-CPA-Owned Entity establishes and maintains the policies and procedures described in paragraphs 5.07–5.09.

5.07 *Policy 1: Non-CPA-Owned Entity adheres to applicable relevant ethical requirements such as those in regulations, interpretations, and rules of the AICPA, state CPA societies, state boards of accountancy, state statutes, the GAO (U.S. Government Accountability Office), and any other applicable regulators.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Developing policies and procedures to ensure the independence of Closely Aligned CPA Firm as required by the applicable aforementioned regulators. (Non-CPA-Owned Entity is required

² If the closely aligned CPA firm were to be engaged to perform audit services for an issuer, the non-CPA-owned entity or its affiliated companies might need to revise their quality control policies and procedures to comply with PCAOB (Public Company Accounting Oversight Board) standards and to reflect SEC (Securities and Exchange Commission) requirements applicable to audits of issuers.

³ The top-tier company is the parent company of the non-CPA-owned entity, which may be an issuer.

⁴ Indirect superiors may be involved in regional management of direct superiors; thus, they may need to adhere to requirements.

to be independent only in the context of its alignment with the CPA firm; it does not perform any attest functions, so its independence is not relevant.)

- Designating an officer to be responsible for providing guidance, answering questions, monitoring compliance, and resolving matters concerning independence, integrity, and objectivity of Closely Aligned CPA Firm.
- Determining when consultation with outside sources regarding independence, integrity, and objectivity matters is required.
- Reviewing written representations from *direct superiors* and *indirect superiors*⁵ and others as applicable and resolving potential independence, integrity, and objectivity matters.
- Maintaining documentation of the resolution of independence, integrity, and objectivity matters.
- Requiring entity personnel to obtain sufficient training and education to accomplish their responsibilities with respect to independence, integrity, and objectivity.
- Obtaining from Closely Aligned CPA Firm a current list of all entities with which firm personnel are prohibited from having a financial or business relationship.⁶
- Obtaining written representations from personnel of Non-CPA-Owned Entity, upon hire and on an annual basis, stating that they are familiar with and in compliance with Non-CPA-Owned Entity's policies and procedures regarding independence, integrity, and objectivity.

5.08 *Policy 2: Personnel of Non-CPA-Owned Entity are familiar with policies and procedures regarding relevant ethical requirements.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Providing all of its personnel with access to its policies and procedures and guidance materials related to independence, integrity, and objectivity, such as manuals, memoranda, and databases containing professional and regulatory literature

⁵ *Direct superiors* are defined to include those persons so closely associated with a partner or manager who is a covered member that such persons can directly control the activities of such partner or manager. For this purpose, a person who can directly control is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. *Indirect superiors* are those persons who are one or more levels above direct superiors. Generally, this would start with persons in an organization structure to whom direct superiors report and go up the line from there.

⁶ Examples of business relationships prohibited by independence standard-setting bodies such as the AICPA, the GAO, and the U.S. Department of Labor because they might impair independence include being an investor in a joint venture with a client that is material or serving as a board member on the board of an audit client.

- Advising personnel of Non-CPA-Owned Entity of the financial or other relationships, circumstances, or activities involving either individuals or entities that may be prohibited, as in the following examples:
 - Business relationships with Closely Aligned CPA Firm's clients or with nonclients that have investor or investee relationships with Closely Aligned CPA Firm's clients
 - Loans to and from Closely Aligned CPA Firm's clients, including loans from Closely Aligned CPA Firm's financial institution clients
 - Family members who are employed by Closely Aligned CPA Firm's clients or who serve as director, officer, manager, or in other audit-sensitive positions with clients of Closely Aligned CPA Firm, including not-for-profit organizations
 - Past due fees from Closely Aligned CPA Firm's clients
 - Services in which the service provider assumes some of the responsibilities of client management
 - Performing certain bookkeeping services for governmental entities that are clients of Closely Aligned CPA Firm
 - Client relationships with Non-CPA-Owned Entity in which Closely Aligned CPA Firm leases employees, facilities, and so on
 - Situations in which personnel of Non-CPA-Owned Entity act as promoters, underwriters, voting trustees, directors, or officers of Closely Aligned CPA Firm's clients
 - Direct and material indirect financial interests in clients of Closely Aligned CPA Firm
 - Material investments by Closely Aligned CPA Firm's clients in Non-CPA-Owned Entity that allow the clients to exercise significant influence over Non-CPA-Owned Entity
- Advising personnel of Non-CPA-Owned Entity of the following:
 - All direct superiors with whom, and all activities in which, Non-CPA-Owned Entity is prohibited from engaging, as defined in Non-CPA-Owned Entity's independence policies and procedures
 - All indirect superiors with whom, and all activities in which, Non-CPA-Owned Entity is prohibited from engaging, as defined by Non-CPA-Owned Entity's policies and procedures
- Obtaining client lists from Closely Aligned CPA Firm to inform all personnel, on a timely basis, of Closely Aligned CPA Firm client's to which independence policies apply

- Obtaining documented representations from all Non-CPA-Owned Entity personnel (including those defined as direct and indirect superiors or supervisors of affiliated issuers),⁷ upon hire and on an annual basis thereafter, stating that they are familiar with and in compliance with policies and procedures regarding relevant ethical requirements

5.09 Policy 3: Non-CPA-Owned Entity identifies and evaluates possible threats to independence and objectivity and takes appropriate action to eliminate those threats or reduce them to an appropriate level by applying safeguards. Non-CPA-Owned Entity implements this policy through the following procedures:

- Assigning responsibility for obtaining, maintaining, and reviewing documented representations from all Non-CPA-Owned Entity personnel (see paragraph 5.08) for completeness and resolving reported exceptions with Non-CPA-Owned Entity's chief executive
- Requiring the chief executive of Non-CPA-Owned Entity to review or to designate an appropriate individual to review unpaid fees from clients of Closely Aligned CPA Firm to ascertain whether any outstanding amounts impair Closely Aligned CPA Firm's independence
- Requiring all professionals to report, on a timely basis when identified, circumstances and relationships that form a threat to independence so that appropriate action can be taken
- Requiring all professionals to report, on a timely basis when identified, apparent violations of independence, integrity, or objectivity policies involving themselves, their spouses, or their dependents and the corrective actions taken or proposed to be taken

HUMAN RESOURCES

5.10 The objective of the human resources element of a system of quality control is to provide the firm with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary (a) to perform its engagements in accordance with professional standards and regulatory and legal requirements and (b) to enable the firm to issue reports that are appropriate in the circumstances. Closely Aligned CPA Firm satisfies this objective by ensuring that Non-CPA-Owned Entity establishes and maintains the policies and procedures comparable to those that are described in paragraphs 5.11–5.13 with regard to its leased or per-diem personnel.

5.11 Policy 1: Leased or per-diem personnel possess characteristics that enable them to competently perform and review engagements. Non-CPA-Owned Entity implements this policy by

⁷ Affiliated issuers include the top-tier company and all entities consolidated in the top-tier company's financial statements. Individuals in these entities are not in situations in which a direct superior can exercise significant influence.

having knowledge and experience equivalent to that of Closely Aligned CPA Firm to make the following decisions:

- Designating an individual from Closely Aligned CPA Firm to be responsible for hiring and managing human resources within Non-CPA-Owned Entity on behalf of Closely Aligned CPA Firm.
- Reviewing Closely Aligned CPA Firm's personnel requirements for attest engagements to ensure that sufficient and capable staff persons are available to perform those engagements.
- Involving members of Closely Aligned CPA Firm in the process of hiring professionals on behalf of Closely Aligned CPA Firm that include establishing the attributes, achievements, and experiences desired in entry-level and experienced personnel. Such criteria assist in evaluating (a) the personal characteristics of professionals, such as integrity, competence, and motivation, and (b) whether professionals can competently perform responsibilities within Closely Aligned CPA Firm.
- Establishing guidelines for additional procedures to be performed when hiring experienced personnel, such as performing background checks and inquiring about any outstanding regulatory actions.
- Establishing criteria for determining which individuals will be involved in interviewing and hiring personnel on behalf of Closely Aligned CPA Firm.

5.12 Policy 2: Leased or per-diem personnel participate in general and industry-specific continuing professional education (CPE) and other professional activities that enable them to accomplish assigned responsibilities and satisfy applicable CPE requirements of the AICPA, state CPA societies, state accountancy boards, and other regulatory agencies. Non-CPA-Owned Entity implements this policy through the following procedures:

- Designating an individual to be responsible for CPE and professional development activities, including maintaining appropriate documentation evidencing that leased and per-diem personnel have met the professional education requirements of the AICPA, state boards of accountancy, and other applicable regulators
- Establishing policies that require individuals performing audits, reviews, compilations, or attestation engagements for Closely Aligned CPA Firm to participate in CPE related to accounting and auditing
- Establishing policies requiring all leased or per-diem personnel to be in compliance with the professional education requirements of the boards of accountancy in states where they are licensed and with the AICPA, state societies, and other regulatory agencies, as applicable
- Establishing an orientation and training policy for new hires who will perform audits, reviews, compilations, or attestation engagements for Closely Aligned CPA Firm or who will have

partner- or manager-level responsibility for the overall supervision or review of such engagements

- Ensuring that leased or per-diem personnel are informed about changes in accounting and auditing standards, independence, integrity, and objectivity requirements, and Closely Aligned CPA Firm's technical policies and procedures that are relevant to them
- Encouraging leased or per-diem personnel to participate in other professional activities, such as graduate-level courses, membership in professional organizations, and serving on professional committees

5.13 Policy 3: Leased or per-diem personnel who are selected for advancement have the qualifications to accomplish the responsibilities they will be called upon to assume. Factors to consider include the degree of technical training and proficiency required in the circumstances and the nature and extent of supervision of assignments relating to audits, reviews, compilations, or attestation engagements performed by Closely Aligned CPA Firm. Non-CPA-Owned Entity implements this policy through the following procedures:

- Establishing a system for providing information to Closely Aligned CPA Firm so that it can make appropriate personnel decisions, such as assignments for audits, reviews, compilations, and attestation engagements.
- Designating an individual to be responsible for the following:
 - Establishing criteria for the evaluation and advancement of leased or per-diem personnel, including appropriate documentation
 - Making advancement and termination decisions, including identifying responsibilities and requirements for evaluation, at each professional level and deciding who will prepare those evaluations
 - Developing appropriate evaluation forms
 - Reviewing performance evaluations with personnel, discussing future objectives of Closely Aligned CPA Firm and the individual, and discussing assignment preferences
 - Periodically evaluating owners of Closely Aligned CPA Firm by means of peer evaluation or self-appraisal
 - Counseling leased or per-diem personnel regarding their progress and career opportunities
- Establishing an arrangement with Closely Aligned CPA Firm in which a supervisory-level individual of Closely Aligned CPA Firm is responsible for assisting Non-CPA-Owned Entity in making advancement and termination decisions concerning leased or per-diem personnel. This would include evaluating personnel needs, establishing hiring objectives, and providing final approval.

- Developing a system for evaluating the performance of leased or per-diem personnel and advising them of their progress.

MONITORING

5.14 The objective of the monitoring element of a system of quality control is to provide the firm and its engagement partners with reasonable assurance that the policies and procedures related to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Monitoring involves an ongoing consideration and evaluation of the appropriateness of the design, the effectiveness of the operation of a firm's quality control system, and a firm's compliance with its quality control policies and procedures. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of the following:

- Adherence to professional standards and regulatory and legal requirements
- Whether the quality control system has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the CPA firm are appropriate in the circumstances

5.15 A CPA firm that is closely aligned with a non-CPA-owned entity satisfies this objective by ensuring that the non-CPA-owned entity establishes and maintains the policies and procedures described in paragraphs 5.16–5.19.

5.16 *Policy 1: Non-CPA-Owned Entity considers and evaluates, on an ongoing basis, the relevance and adequacy of its policies and procedures related to relevant ethical requirements that are applicable to all its personnel and its personnel management policies and procedures that are applicable to leased or per-diem personnel.* Non-CPA-Owned Entity implements this policy by designating qualified individuals to be responsible for monitoring quality assurance, including ensuring that Non-CPA-Owned Entity's quality control guidance is regularly updated to reflect changes in professional standards related to independence, CPE, and other regulatory requirements through the following procedures:

- Implementing a system of ongoing monitoring of the effectiveness and appropriateness of policies and procedures related to independence, objectivity, and integrity as applicable to all personnel of Non-CPA-Owned Entity and compliance with those policies and procedures
- Ensuring, on an ongoing basis, that guidance materials and any practice aids Non-CPA-Owned Entity provides to Closely Aligned CPA Firm are appropriately designed to assist Closely Aligned CPA Firm in adhering to quality control standards

- Maintaining a system to ensure that the practice aids regarding independence and other technical matters provided by Non-CPA-Owned Entity are updated to reflect current professional standards and regulatory requirements and are relevant to and effective for Closely Aligned CPA Firm's practice
- Ensuring that Non-CPA-Owned Entity informs and provides guidance to leased or per-diem personnel regarding new professional standards, regulatory requirements, and related changes to relevant Closely Aligned CPA Firm policies or practice aids

5.17 *Policy 2: Non-CPA-Owned Entity considers and evaluates, on an ongoing basis, compliance with its policies and procedures related to relevant ethical requirements that are applicable to all of its personnel and personnel management policies and procedures that are applicable to leased or per-diem personnel.* Non-CPA-Owned Entity implements this policy by considering and evaluating, on an ongoing basis, compliance with policies and procedures related to independence, integrity, and objectivity, as applicable to all of its personnel, through the following procedures:

- Performing timely monitoring of policies and procedures, on an ongoing basis, related to independence, integrity, and objectivity to evaluate compliance with those policies and procedures. The monitoring policies and procedures could include an internal audit function, ongoing review by senior management, or engaging an independent CPA to examine and report on compliance.
- Summarizing and communicating the results of the monitoring to all of its personnel and communicating any suggested changes to policies and procedures to the appropriate levels of personnel in Non-CPA-Owned Entity.
- Correcting noted deficiencies based on the results of the monitoring to ensure compliance with policies and procedures.

5.18 *Policy 3: Non-CPA-Owned Entity deals appropriately with complaints and allegations.* Non-CPA-Owned Entity implements this policy through the following procedures:

- Establishing procedures for concerns to be brought to the attention of the ethics committee in a confidential manner
- Having the firm's ethics committee (excluding any members who are otherwise involved in the engagement under investigation) investigate the following:
 - Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements
 - Allegations of noncompliance with the firm's system of quality control

- Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations
- Documenting complaints and allegations and the responses to them

5.19 *Policy 4: Non-CPA-Owned Entity prepares appropriate documentation to provide evidence of the operation of each element of its system of quality control.* Non-CPA-Owned Entity implements this policy by preparing and retaining documentation that provides evidence of the operation of the system of quality control for a period of time sufficient to permit those performing monitoring procedures to evaluate the firm's compliance with its system of quality control.

APPENDIX A

STATEMENT ON QUALITY CONTROL STANDARDS

Issued by the Auditing Standards Board

October 2007

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A FIRM'S SYSTEM OF QUALITY CONTROL

(Supersedes Statement on Quality Control Standards [SQCS] No. 2, System of Quality Control For a CPA Firm's Accounting and Auditing Practice, as amended; SQCS No. 3, Monitoring a CPA Firm's Accounting and Auditing Practice; SQCS No. 4, Amendment to SQCS No. 2; SQCS No. 5, The Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement; and SQCS No. 6, Amendment to SQCS No. 2 [AICPA, Professional Standards, vol.2].)

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INTRODUCTION

1. The purpose of this Statement on Quality Control Standards (SQCS) is to establish standards and provide guidance for a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This statement describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system. This statement is to be read in conjunction with the AICPA Code of Professional Conduct.
2. This statement also sets forth the meaning of certain terms used in SQCSs issued by the Auditing Standards Board in describing the professional requirements imposed on firms and engagement partners.

SYSTEM OF QUALITY CONTROL

3. The firm must establish a system of quality control designed to provide the firm with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances. A system of quality control consists of policies designed to achieve these objectives and the procedures necessary to implement and monitor compliance with those policies.
4. The nature of the policies and procedures developed by individual firms to comply with this statement will depend on various factors such as the size and operating characteristics of the firm. The system of quality control should be designed to provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign member firms or offices or by its domestic or foreign affiliates, if any, are performed in accordance with professional standards in the United States when such standards are applicable.

DEFINITIONS

5. In this statement, the following terms have the meanings given below:
 - a. *Accounting and auditing practice*. A practice that performs engagements covered by this statement, which are audit, attestation, compilation, review and any other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rules 201 or 202 of the AICPA Code of Professional Conduct. Although standards for other engagements may be established by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.
 - b. *Engagement documentation*. The record of work performed, results obtained, and conclusions the practitioner reached, also known as *working papers* or *workpapers*.

- c. *Engagement partner.* An individual responsible for supervising engagements covered by this statement and signing or authorizing an individual to sign the report on such engagements, and who, where required, has the appropriate authority from a professional, legal or regulatory body. Firms may use different titles to refer to individuals with this authority.
- d. *Engagement quality control review.* A process designed to provide an objective evaluation, by an individual or individuals who are not members of the engagement team, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.
- e. *Engagement quality control reviewer.* A partner, other person in the firm, qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to perform the engagement quality control review.
- f. *Engagement team.* All personnel performing the engagement, excluding those who perform the engagement quality control review. The engagement team (i) includes all employees and contractors retained by the firm who perform engagement procedures, irrespective of their functional classification (for example, audit, tax, or management consulting services) and (ii) excludes specialists as discussed in AU section 336, Using the Work of a Specialist, and individuals who perform only routine clerical functions, such as word processing and photocopying.
- g. *Firm.* A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting.
- h. *Inspection.* A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures and the extent of the firm's compliance with them. Inspection is an element of monitoring.
- i. *Monitoring.* A process comprising an ongoing consideration and evaluation of the firm's system of quality control, the objective of which is to enable the firm to obtain reasonable assurance that its system of quality control is designed appropriately and operating effectively.
- j. *Partner.* An individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.
- k. *Personnel.* All individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.
- l. *Professional standards.* Standards established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rules 201 or 202 of the

AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET secs. 201–202) or other standard setting bodies that set auditing and attest standards applicable to the engagement being performed.

- m. *Qualified external person*. An individual outside the firm with the capabilities and competence to act as an engagement partner.
- n. *Reasonable assurance*. In the context of this standard, a high, but not absolute, level of assurance.
- o. *Relevant ethical requirements*. Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies, which may be more restrictive.
- p. *Staff*. Personnel, other than partners and engagement partners, including any specialists who are employees of the firm.

Professional Requirements

6. SQCSs contain professional requirements together with related guidance in the form of explanatory material. Firms have a responsibility to consider the entire text of an SQCS with regard to their system of quality control and in understanding and applying the professional requirements of the relevant SQCSs.

7. Not every paragraph of an SQCS carries a professional requirement that the firm is expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in the SQCSs.

8. SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:

- *Unconditional requirements*. The firm is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SQCSs use the words *must* or *is required* to indicate an unconditional requirement.
- *Presumptively mandatory requirements*. The firm is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement provided the practitioner documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm “should consider,” the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

Explanatory Material

9. Explanatory material is defined as the text within an SQCS (excluding any related interpretations¹) that may:

- Provide further explanation and guidance on the professional requirements; or
- Identify and describe other procedures or actions relating to the activities of the firm.

10. Explanatory material that provides further explanation and guidance on the professional requirements is intended to be descriptive rather than imperative. That is, it explains the objective of the professional requirements (where not otherwise self-evident); it explains why the firm might consider or employ particular procedures, depending on the circumstances; and it provides additional information for the firm to consider in exercising professional judgment with regard to its system of quality control.

11. Explanatory material that identifies and describes other procedures or actions relating to the activities of the firm is not intended to impose a professional requirement for the firm to perform the suggested procedures or actions. Rather, these procedures or actions require the firm’s attention and understanding; how and whether the firm carries out such procedures or actions with regard to its system of quality control depends on the exercise of professional judgment in the circumstances consistent with the objective of the standard. The words *may*, *might*, and *could* are used to describe these actions and procedures.

DOCUMENTATION AND COMMUNICATION OF QUALITY CONTROL POLICIES AND PROCEDURES

12. The firm should document its quality control policies and procedures. The size, structure, and nature of the practice of the firm are important considerations in determining the extent of the documentation of established quality control policies and procedures. For example, documentation of established quality control policies and procedures would generally be expected to be more extensive in a large firm than in a small firm and in a multi-office firm than in a single-office firm.

¹ Interpretive publications differ from explanatory material. Interpretive publications, for example, interpretations of the SQCSs, reside outside of the standards section of an SQCS and are recommendations on the application of the SQCS in specific circumstances. In contrast, explanatory material is always contained within the standards sections of the SQCS and is meant to be more descriptive in nature.

13. The firm should communicate its quality control policies and procedures to its personnel. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing. Effective communication of the firm's quality control policies and procedures:

- Describes the quality control policies and procedures and the objectives they are designed to achieve;
- Includes the message that each individual has a personal responsibility for quality and is expected to be familiar with and to comply with these policies and procedures; and
- Stresses the importance of obtaining feedback on its system of quality control from its personnel and encourages its personnel to communicate their views or concerns on quality control matters.

ELEMENTS OF A SYSTEM OF QUALITY CONTROL

14. The firm's system of quality control should include policies and procedures addressing each of the following elements:

- a. Leadership responsibilities for quality within the firm (the "tone at the top")
- b. Relevant ethical requirements
- c. Acceptance and continuance of client relationships and specific engagements
- d. Human resources
- e. Engagement performance
- f. Monitoring

Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

15. The firm should promote an internal culture based on the recognition that quality is essential in performing engagements and should establish policies and procedures to support that culture. Such policies and procedures should require the firm's leadership (managing partner or board of managing partners, chief executive officer, or equivalent) to assume ultimate responsibility for the firm's system of quality control.

16. The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures, and the requirement to:

- a. Perform work that complies with professional standards and regulatory and legal requirements.
- b. Issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

17. Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Accordingly, the firm should establish policies to:

- a. Assign management responsibilities so that commercial considerations do not override the quality of work performed;
- b. Address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel, to demonstrate the firm's overarching commitment to the objectives of the system of quality control; and
- c. Devote sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

18. Any person or persons assigned operational responsibility for the firm's quality control system by the firm's leadership should have sufficient and appropriate experience and ability to identify and understand quality control issues and to develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.

Relevant Ethical Requirements

19. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

20. The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include:

- Responsibilities
- The public interest
- Integrity

- Objectivity and independence
- Due care
- Scope and nature of services

21. The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel, and, where applicable, others subject to independence requirements, maintain independence where required. Independence requirements are set forth in Rule 101 and its related interpretations and rulings of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence, including the familiarity threat that may be created by using the same senior personnel on an audit or attest engagement over a long period of time, and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct, are set forth in the AICPA's Conceptual Framework for AICPA Independence Standards. Such policies and procedures should enable the firm to:

- a. Communicate its independence requirements to its personnel and, where applicable, others subject to them.
- b. Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if effective safeguards cannot be applied, withdrawing from the engagement.

22. Such policies and procedures should require:

- a. The engagement partner to consider relevant information about client engagements, including the scope of services, to enable him or her to evaluate the overall effect, if any, on independence requirements.
- b. Personnel to promptly notify the engagement partner and the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken.
- c. The accumulation and communication of relevant information to appropriate personnel so that:
 - (i) The firm, the engagement partner, and other firm personnel can readily determine whether they satisfy independence requirements;
 - (ii) The firm can maintain and update information relating to independence; and
 - (iii) The firm and the engagement partner can take appropriate action regarding identified threats to independence.

23. The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for:

- a. Personnel to promptly notify the firm of independence breaches of which they become aware.
- b. The firm to promptly communicate identified breaches of these policies and procedures and the required corrective actions to:
 - (i) The engagement partner who, with the firm, has the responsibility to address the breach; and
 - (ii) Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action.
- c. Confirmation to the firm by the engagement partner and the other individuals referred to in subparagraph b.(ii) that the required corrective actions have been taken.

24. At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in Rule 101 and its related interpretations and rulings of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 101) and the rules of state boards of accountancy and applicable regulatory agencies. Written confirmation may be in paper or electronic form.

25. The purpose of obtaining confirmation and taking appropriate action on information indicating noncompliance is to demonstrate the importance that the firm attaches to independence and keep the issue current for and visible to its personnel.

26. For all audit or attestation engagements where regulatory or other authorities require the rotation of personnel after a specified period, the firm's policies and procedures should address these requirements.

Acceptance and Continuance of Client Relationships and Specific Engagements

27. The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where the firm:

- a. Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, related parties, and those charged with its

governance, and the risks associated with providing professional services in the particular circumstances;

- b. Is competent to perform the engagement and has the capabilities and resources to do so; and
- c. Can comply with legal and ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

28. To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services. Professional standards may provide guidance in deciding whether the understanding should be oral or written.

29. When issues have been identified, and the firm has decided to accept or continue the client relationship or a specific engagement, the firm should document how the issues were resolved.

30. Factors to consider regarding the integrity of a client include:

- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control over financial reporting.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

31. Matters to consider in accepting or continuing the client engagement include whether:

- Firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;
- Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to effectively gain the necessary competencies;
- The firm has sufficient personnel with the necessary capabilities and competence;
- Specialists are available, if needed;
- Individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, where applicable; and
- The firm is able to complete the engagement within the reporting deadline.

32. If a potential conflict of interest is identified in accepting an engagement from a new or an existing client, the firm should determine whether it is appropriate to accept the engagement. Where the engagement is accepted, the firm should consider any ethical requirements that exist under AICPA Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102), such as disclosure of the relationship to the client and other appropriate parties.

33. Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements, and their implications for continuing the relationship.

34. If the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of the professional and legal responsibilities that apply to the circumstances, and the possibility of withdrawing from the engagement or from both the engagement and the client relationship.

35. Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship should include documenting significant issues, consultations, conclusions, and the basis for the conclusions. Policies and procedures may include:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances.
- Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship.

36. In certain situations, the auditor may be appointed by statutory procedures or required by law or regulation to perform the engagement. Accordingly, certain of the considerations regarding the acceptance and continuance of client relationships and specific engagements, as set out in paragraphs 27–35, may not be relevant. Nonetheless, establishing policies and procedures as described may provide valuable information to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Human Resources

37. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to

- a. Perform its engagements in accordance with professional standards and regulatory and legal requirements, and
- b. Enable the firm to issue reports that are appropriate in the circumstances.

38. Such policies and procedures should address the following:

- Recruitment and hiring, if applicable;
- Determining capabilities and competencies;
- Assigning personnel to engagements, if applicable;
- Professional development; and
- Performance evaluation, compensation, and advancement.

Recruitment and Hiring

39. Effective recruitment processes and procedures help the firm select individuals of integrity, who have the capacity to develop the capabilities and competence necessary to perform the firm's work, and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

Determining Capabilities and Competencies

40. Capabilities and competencies are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this statement. Capabilities and competencies are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

41. Capabilities and competence are developed through a variety of methods; for example:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff; for example, other members of the engagement team

Competencies of Engagement Partner

42. A firm's quality control policies and procedures should provide reasonable assurance that an engagement partner possesses the competencies necessary to fulfill his or her engagement responsibilities.

43. In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this statement. In some cases, however, an engagement partner may have obtained the necessary competencies through disciplines other than the practice of public accounting, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by continuing professional education (CPE) and consultation. The following are examples.

- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
- An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.
- A person in academia might obtain the necessary competencies to perform engagements covered by this statement by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (b) performing a rigorous self-study program, or by engaging a consultant to assist on such engagements.

44. The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner for an engagement. For example:

- The competencies expected of an engagement partner for an engagement to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
- Supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.
- The engagement partner for an attestation engagement to examine management's assertion about the effectiveness of an entity's internal control over financial reporting would be

expected to have technical proficiency in understanding and evaluating the effectiveness of controls, while an engagement partner for an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

45. In practice, the competency requirements necessary for the engagement partner are broad and varied in both their nature and number. Required competencies include the following, as well as other competencies as necessary in the circumstances.

- *Understanding of the role of a system of quality control and the Code of Professional Conduct.* An understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.
- *Understanding of the service to be performed.* An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.
- *Technical proficiency.* An understanding of the applicable professional standards including those standards directly related to the industry in which a client operates and the kinds of transactions in which a client engages.
- *Familiarity with the industry.* An understanding of the industry in which a client operates, to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.
- *Professional judgment.* Skills that indicate sound professional judgment. In performing engagements covered by this statement; such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.
- *Understanding the organization's information technology systems.* A sufficient understanding of how the organization is dependent on or enabled by information technologies and the manner in which the information systems are used to record and maintain financial information, to determine when involvement of an IT professional is necessary for an audit engagement.

Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control

46. The competencies listed above are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

47. In establishing policies and procedures related to the nature of competencies needed by the engagement partner for an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.

The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control

48. CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern the practice of public accounting. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute and related administrative rules designed by the AICPA and the National Association of State Boards of Accountancy (NASBA) to provide a uniform approach to the regulation of the accounting profession. The UAA provides that "any individual licensee who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this statement is intended to enable a practitioner who performs the services described in the preceding sentence on the firm's behalf to meet the competency requirement referred to in the UAA.

Assignment of Engagement Teams

49. The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that

- a. The identity and role of the engagement partner are communicated to management and those charged with governance;
- b. The engagement partner has the appropriate capabilities, competence, authority, and time to perform the role; and
- c. The responsibilities of the engagement partner are clearly defined and communicated to that individual.

50. Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

51. The firm should establish policies and procedures to assign appropriate staff with the necessary capabilities, competence, and time to

- a. Perform engagements in accordance with professional standards and regulatory and legal requirements; and
- b. Enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

52. When assigning engagement teams, and in determining the level of supervision required, the firm might consider factors such as the engagement team's

- Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and regulatory and legal requirements.
- Technical knowledge and expertise, including knowledge of relevant information technology.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

53. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

Professional Development

54. The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and to satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required capabilities and competence. The firm may

use an external source that is qualified for that purpose if internal technical and training resources are unavailable, or for any other reason.

Performance Evaluation, Compensation, and Advancement

55. The firm's policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

56. Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps a firm may take in developing and maintaining competence and commitment to ethical principles include:

- Making personnel aware of the firm's expectations regarding performance and ethical principles;
- Providing personnel with evaluation of, and counseling on, performance, progress, and career development; and
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.

The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

Engagement Performance

57. The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are consistently performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances. Required policies and procedures should address

- a. Engagement performance,
- b. Supervision responsibilities, and
- c. Review responsibilities.

58. Effective policies and procedures facilitate consistency in the quality of engagement performance. This may be accomplished through written or electronic manuals, software tools or

other forms of standardized documentation, and industry- or subject-matter-specific guidance materials. The firm might address, for example:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work,
- Processes for complying with applicable engagement standards,
- Processes of engagement supervision, staff training, and mentoring,
- Methods of reviewing the work performed, the significant judgments made, and the type of report being issued,
- Appropriate documentation of the work performed and of the timing and extent of the review,
- Appropriate communication of the results of each engagement, and
- Processes to keep all policies and procedures current.

59. Policies and procedures for engagement supervision might include

- Tracking the progress of the engagement;
- Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement;
- Addressing significant issues arising during the engagement, considering their significance, and appropriately modifying the planned approach; and
- Identifying matters for consultation or consideration by more-experienced engagement team members during the engagement.

60. Review responsibility policies and procedures should be determined on the basis that qualified engagement team members, which may include the engagement partner, review work performed by other team members on a timely basis.

61. A review may include consideration of whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant findings and issues have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- The nature, timing, and extent of work performed is appropriate and without need for revision;

- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

62. The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis, as appropriate for the nature of the engagement, after the engagement reports have been released. Professional standards, laws, or regulations may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed.

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation

63. The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.

64. Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or there is a legal or professional duty to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

65. Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, and retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge, or could be permanently lost or damaged. Appropriate and reasonable controls for engagement documentation may include those that

- Clearly determine when and by whom engagement documentation was prepared or reviewed;
- Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
- Prevent unauthorized changes to the engagement documentation; and
- Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

66. Controls that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include, for example:

- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users;
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement;
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement; and
- Procedures for restricting access to and enabling proper distribution and confidential storage of hardcopy engagement documentation.

67. For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In that case, the firm should establish procedures designed to maintain the integrity, accessibility, and retrievability of the documentation.

68. These procedures may include, for example:

- Generating scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;
- Integrating the scanned copies into the engagement files, including indexing and signing off on the copies as necessary; and
- Enabling the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons to retain original paper documentation.

Retention of Engagement Documentation

69. The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations.

70. In determining the needs of the firm for retention of engagement documentation and the period of such retention, the firm may consider the nature of the engagement and the firm's circumstances; for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether professional standards, laws, or regulations prescribe specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the absence of specific legal or regulatory requirements.

71. Procedures that the firm may adopt for retention of engagement documentation include those that

- Enable the retrieval of and access to the engagement documentation during the retention period, particularly in the case of electronic documentation, as the underlying technology may be upgraded or changed over time.
- Provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
- Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Consultation

72. The firm should establish policies and procedures designed to provide it with reasonable assurance that

- a. Consultation takes place when appropriate (for example, when dealing with complex, unusual, unfamiliar, difficult, or contentious issues);
- b. Sufficient and appropriate resources are available to enable appropriate consultation to take place;
- c. All the relevant facts known to the engagement team are provided to those consulted;
- d. The nature and scope of such consultations are documented, and are understood by both the individual seeking consultation and the individual consulted; and
- e. The conclusions resulting from such consultations are documented and implemented.

73. Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have relevant specialized expertise.

74. Consultation uses appropriate research resources as well as the collective experience and technical expertise of the firm. Consultation helps to promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps to promote a culture in which consultation is recognized as a strength and encourages personnel to consult on complex, unusual, unfamiliar, difficult, or contentious issues.

75. The firm's consultation procedures should provide for consultation with those having appropriate knowledge, seniority, and experience within the firm (or, where applicable, outside the firm) on significant technical, ethical, and other matters, and for appropriate documentation and implementation of conclusions resulting from consultations.

76. A firm needing to consult externally may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services. Before using such services, the firm should evaluate whether the external provider is qualified for that purpose.

77. Documentation of consultations with other professionals that involve complex, unusual, unfamiliar, difficult, or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

Differences of Opinion

78. The firm should establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted, and, where applicable, between the engagement partner and the engagement quality control reviewer (including a qualified external person). Such policies and procedures should require that

- a. Conclusions reached be documented and implemented; and
- b. The report not be released until the matter is resolved.

79. Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Quality Control Review

80. The firm should establish criteria against which all engagements covered by this statement are to be evaluated to determine whether an engagement quality control review should be performed.

81. The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review be performed for that engagement, and that the review be completed before the report is released.

82. The firm's policies and procedures should require the engagement partner to remain responsible for the engagement and its performance, notwithstanding involvement of the engagement quality control reviewer.

83. The structure and nature of the firm's practice are important considerations in establishing criteria to consider when determining which engagements are to be subject to an engagement quality control review. Such criteria may include

- The nature of the engagement, including the extent to which it involves a matter of public interest;

- The identification of unusual circumstances or risks in an engagement or class of engagements; and
- Whether laws or regulations require an engagement quality control review.

84. If the firm has no engagements that meet the criteria, paragraphs 85–99 do not apply.

Nature, Timing, and Extent of the Engagement Quality Control Review

85. The engagement quality control review procedures should include an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report.

86. The engagement quality control review should include reading the financial statements or other subject matter information and the report and considering whether the report is appropriate.

87. An engagement quality control review also should include a review of selected engagement documentation relating to the significant judgments the engagement team made and the conclusions they reached, and should include a discussion with the engagement partner regarding significant findings and issues. The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances.

88. An engagement quality control review may include consideration of the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement;
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations; and
- Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.

89. Significant judgments made by the engagement team may include, for example:

- Significant risks identified during the engagement and the responses to those risks.
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.
- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

90. The firm's policies and procedures should require the engagement quality control reviewer to conduct the review in a timely manner so that significant issues may be promptly resolved to the reviewer's satisfaction before the report is released. The review may be conducted at appropriate stages during the engagement.

91. When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply (see paragraphs 78–79).

Criteria for the Eligibility of Engagement Quality Control Reviewers

92. The firm should establish policies and procedures addressing

- a. The appointment of engagement quality control reviewers; and
- b. The technical qualifications required to perform the role, including the necessary experience and authority.

93. The firm's policies and procedures on the technical qualifications of engagement quality control reviewers may address the technical expertise, experience, and authority necessary to fulfill the role. What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

94. The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that while the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.

95. Policies and procedures designed to maintain the objectivity of the engagement quality control reviewer may include a requirement, where practicable, that the engagement quality control reviewer is not selected by the engagement partner, and requirements that the engagement quality control reviewer not

- a. Participate in the performance of the engagement except as discussed in paragraph 96 or
- b. Make decisions for the engagement team.

It may not be practicable, in the case of firms with few partners, for the engagement partner not to be involved in selecting the engagement quality control reviewer.

96. The engagement partner may consult the engagement quality control reviewer at any stage during the engagement, for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer. Such consultation need not impair the engagement quality control reviewer's eligibility to perform the role. However, when

the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity.

97. The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review has been impaired.

98. Qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts qualified external persons or other firms, the requirements and guidance in paragraphs 85–97 apply.

Documentation of the Engagement Quality Control Review

99. The firm should establish policies and procedures that provide for appropriate documentation of the engagement quality control review, including documentation that

- a. The procedures required by the firm's policies on engagement quality control review have been performed;
- b. The engagement quality control review has been completed before the report is released; and
- c. The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

Monitoring

100. The firm should establish policies and procedures designed to provide the firm and its engagement partners with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Such policies and procedures should

- a. Include an ongoing consideration and evaluation of the firm's system of quality control to determine
 - (i) The appropriateness of the design and
 - (ii) The effectiveness of the operation of the system of quality control.
- b. Assign responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.
- c. Assign performance of monitoring of the firm's system of quality control to qualified individuals.

101. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of

- Adherence to professional standards and regulatory and legal requirements;
- Whether the quality control system has been appropriately designed and effectively implemented; and
- Whether the firm's quality control policies and procedures have been operating effectively, so that reports that are issued by the firm are appropriate in the circumstances.

The evaluation may identify circumstances that necessitate changes to, or the need to improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

102. The firm's policies should require the performance of monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and regulatory requirements, and the firm's quality control policies and procedures. Monitoring procedures include

- Review of selected administrative and personnel records pertaining to the quality control elements.
- Review of engagement working papers, reports, and clients' financial statements.
- Discussions with the firm's personnel.
- Summarization of the findings from the monitoring procedures, at least annually, and consideration of the systemic causes of findings that indicate improvements are needed.
- Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures.
- Communication of the identified findings to appropriate firm management personnel.
- Consideration of findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis.

103. Monitoring procedures also include an assessment of

- The appropriateness of the firm's guidance materials and any practice aids;
- New developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm's policies and procedures where appropriate;
- Compliance with policies and procedures on independence;
- The effectiveness of continuing professional development, including training;

- Decisions related to acceptance and continuance of client relationships and specific engagements; and
- Firm personnel's understanding of the firm's quality control policies and procedures, and implementation thereof.

104. Some of the monitoring procedures discussed above may be accomplished through the performance of

- Engagement quality control review.
- Post-issuance review of engagement working papers, reports, and clients' financial statements for selected engagements.
- Inspection procedures.

105. The need for and extent of inspection procedures depends in part on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

106. The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, including the following:

- The size of the firm.
- The number and geographical location of offices.
- The results of previous monitoring procedures.
- The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
- The nature and complexity of the firm's practice and organization.
- The risks associated with the firm's clients and specific engagements.

107. The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections. (See paragraph 119.)

108. Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

109. In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes post-issuance review of engagement working papers, reports, and clients' financial statements by the person with final responsibility for the engagement. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and in the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

110. Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a qualified individual from outside the firm to perform inspection procedures.

111. Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this statement do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards. The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they require prompt corrective action.

112. Deficiencies identified during the monitoring process may be

- a. Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or
- b. Systemic, repetitive or other significant deficiencies that require prompt corrective action.

113. The firm should communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.

114. The firm's evaluation of each type of deficiency should result in recommendations for one or more of the following:

- a. Taking appropriate remedial action in relation to an individual engagement or member of personnel.
- b. The communication of the findings to those responsible for training and professional development.
- c. Changes to the quality control policies and procedures.
- d. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.

115. When the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm should determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. The firm may also consider obtaining legal advice.

116. At least annually, the firm should communicate the results of the monitoring of its quality control system process to relevant engagement partners and other appropriate individuals within the firm, including the firm's leadership. Such communication should enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities and provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:

- a. A description of the monitoring procedures performed.
- b. The conclusions drawn from the monitoring procedures.
- c. Where relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.

117. The reporting of identified deficiencies to individuals other than the relevant engagement partner need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partner.

118. The firm should establish policies and procedures requiring appropriate documentation of monitoring (see paragraph 125). Appropriate documentation relating to monitoring includes:

- a. Monitoring procedures, including the procedure for selecting completed engagements to be inspected;
- b. A record of the evaluation of:
 - (i) Adherence to professional standards and regulatory and legal requirements;

- (ii) Whether the quality control system has been appropriately designed and effectively implemented; and
 - (iii) Whether the firm's quality control policies and procedures have been operating effectively, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
- c. Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary.

The Relationship of Peer Review to Monitoring

119. A peer review does not substitute for all monitoring procedures. However, since the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement working papers, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

Complaints and Allegations

120. The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with

- a. Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
- b. Allegations of noncompliance with the firm's system of quality control; and
- c. Deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

121. As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

122. Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

123. The firm should require that investigations of such complaints and allegations in accordance with established policies and procedures be supervised by a person with sufficient and appropriate experience and authority who is not otherwise involved in the engagement. The firm's

policies and procedures may require involving legal counsel in the investigation. Small firms and sole practitioners may use the services of a qualified external person or another firm to carry out the investigation.

124. The firm should establish policies and procedures requiring documentation of complaints and allegations, and the responses to them.

DOCUMENTATION OF OPERATION OF QUALITY CONTROL POLICIES AND PROCEDURES

125. The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.

126. The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including, for example:

- The size of the firm and the number of offices.
- The nature and complexity of the firm's practice and organization.

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections. Smaller firms may use more informal methods such as manual notes, checklists, and forms.

127. The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

EFFECTIVE DATE

128. The provisions of this statement are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2009.

This Statement entitled A Firm's System of Quality Control was unanimously adopted by the assenting votes of the 19 members of the board.

**Auditing Standards Board
(2006-2007)**

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Note: Statements on Quality Control Standards are issued by the Auditing Standards Board, the senior technical body of the Institute designated to issue pronouncements on auditing, attestation and quality control matters. Rule 202, Compliance With Standards, of the Institute's Code of Professional Conduct requires AICPA members who perform professional services to comply with these standards.

APPENDIX B: INTERPRETATION NO. 101-14 OF RULE 101

INTERPRETATION NO. 101-14 OF RULE 101, *INDEPENDENCE*, “THE EFFECT OF ALTERNATIVE PRACTICE STRUCTURES ON THE APPLICABILITY OF INDEPENDENCE RULES” (AICPA, *PROFESSIONAL STANDARDS*, VOL. 2, ET SEC. 101.16)

Because of changes in the manner in which **members**^{*} are structuring their practices, the AICPA’s professional ethics executive committee (PEEC) studied various alternatives to “traditional structures” to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many “nontraditional structures,” a substantial (the nonattest) portion of a member’s practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, *Form of Organization and Name* [ET section 505.01]. In complying with laws, regulations, and rule 505 [ET section 505.01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [ET section 505.01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the “traditional firm” engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

^{*} Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, *Definitions*. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

The example APS in this interpretation is one where an existing CPA practice (“Oldfirm”) is sold by its owners to another (possibly public) entity (“PublicCo”). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo’s subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm (“Newfirm”) to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

APS Independence Rules for Covered Members

The term **covered member** in an APS includes both employed and leased individuals. The **firm** in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

Partners of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

APS Independence Rules for Persons and Entities Other Than Covered Members

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the “traditional firm” (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. Direct Superiors. Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can *directly control* the activities of such partner or manager. For this purpose, a person who can *directly control* is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (e.g. through another entity over which the Direct Superior can exercise significant influence³⁵ derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. *Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence³⁶ are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.*

2. Indirect Superiors and Other PublicCo Entities. Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the **immediate family** of the Indirect Superior.

³⁵ For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]

³⁶ For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

A. Indirect Superiors and Other PublicCo Entities may *not* have a relationship contemplated by interpretation 101-1.A [ET section 101.02] (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity's financial statements.

B. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence³⁷ over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.

³⁷ For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]

C. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.

D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

Other Matters

1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.

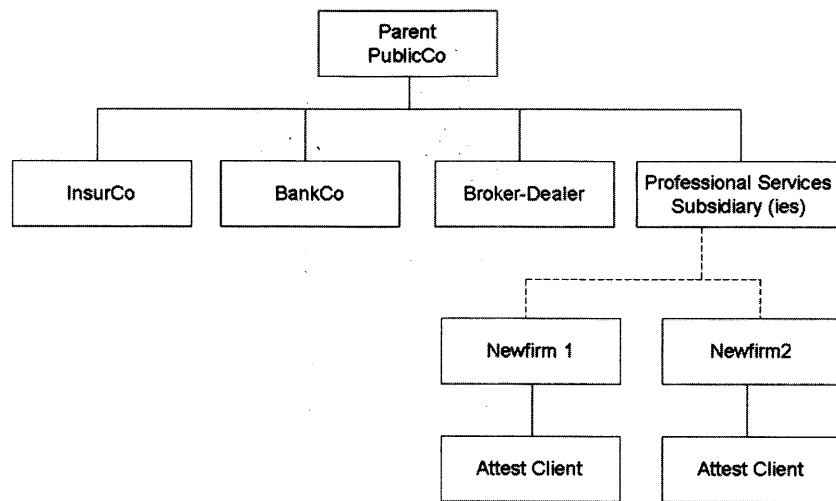
2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an **attest engagement** for PublicCo or any of its subsidiaries or divisions.

3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence³⁸ over PublicCo.

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, *Conflicts of Interest* [ET section 102.03].

³⁸ For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Accounting Principles Board Opinion No. 18 [AC section I82] and its interpretations to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]

Alternative Practice Structure (APS) Model



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